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INVESTMENT TRUSTS AND INVESTMENT COMPANIES

LETTER

FROM THE

CHAIRMAN OF THE
SECURITIES AND EXCHANGE COMMISSION

TRANSMITTING, PURSUANT TO LAW, A REPORT ON
COMPANIES ISSUING FACE AMOUNT
INSTALLMENT CERTIFICATES



MARCH 13, 1940.—Referred to the Committee on Interstate and Foreign Commerce and ordered to be printed with illustration

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON: 1940

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Mar. 28, 1950

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LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D. C., March 13, 1940.

SIR: I have the honor to transmit herewith a Report on Companies Issuing Face Amount Installment Certificates, which supplements the Commission's over-all report on its study of investment trusts and investment companies, made pursuant to Section 30 of the Public Utility Holding Company Act of 1935. This report is one of a series of supplemental reports to be transmitted to the Congress by the Commission on special phases of its study of investment trusts and investment companies. A list of the supplemental reports and of the parts of the over-all report which have already been transmitted to the Congress will be found on the following page.

This report is based almost exclusively on data furnished by the companies in response to the Commission's questionnaire without any independent verification of these figures by the Commission. Subsequent to the Commission's preparation of this report Investors Syndicate filed a registration statement for new series of its certificates under the Securities Act of 1933. In connection with this registration statement the Commission is to receive a substantial amount of data with respect to the financial condition and activities of the company. This additional information may modify and expand the information previously furnished to the Commission by the company upon which this instant report is based. The analysis contained in this report transmitted to the Congress therefore must in some respects be deemed tentative as to Investors Syndicate. In the event that any substantial difference exists between the information previously furnished and the information to be furnished, a supplemental report incorporating these modifications may be transmitted to the Congress.

The study and report were under the general supervision of Commissioner Robert E. Healy, with Paul P. Gourrich, former technical adviser to the Commission as director of the study, the late William R. Spratt, Jr., as chief of the study, David Schenker as counsel and L. M. C. Smith as associate counsel. Paul P. Gourrich, former director of the study, whose resignation from the Commission was submitted on March 31, 1939, and William R. Spratt, Jr., former chief of the study, whose death occurred on June 20, 1938, did not participate in the preparation or consideration of this report.

The preparation of the Report on Companies Issuing Face Amount Installment Certificates was under the immediate supervision of Alfred H. Smith of the economic and analysis section and Harry S. Carver of the legal section of the staff.

By direction of the Commission:

JEROME N. FRANK, *Chairman.*

The PRESIDENT OF THE SENATE.

The SPEAKER OF THE HOUSE OF REPRESENTATIVES.

LIST OF REPORTS SUBMITTED

Part One, Part Two, and Chapters I to VI of Part Three of the over-all report have heretofore been transmitted by the Commission to the Congress. Part One, which was transmitted by the Commission to the 75th Congress on June 10, 1938, consists of a discussion of the nature, classification, and origins of investment trusts and investment companies, and has been printed as House Document No. 707, 75th Congress. Part Two, the transmission of which to the 76th Congress was completed on March 10, 1939, consists of a statistical survey of investment trusts and investment companies and has been ordered printed as House Document No. 70, 76th Congress. Part Three, of which the most recent section was transmitted to the 76th Congress on February 8, 1940, deals with the abuses and deficiencies in the organization and operation of investment trusts and investment companies and has been ordered printed as House Document No. 279, 76th Congress.

The Commission has also transmitted to the Congress five supplemental reports, namely: Investment Trusts in Great Britain, transmitted on June 26, 1939, and printed as House Document No. 380, 76th Congress; Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services, transmitted on August 17, 1939, and printed as House Document No. 477, 76th Congress; Commingled or Common Trust Funds Administered by Banks and Trust Companies, transmitted on August 30, 1939, and printed as House Document No. 476, 76th Congress; Companies Sponsoring Installment Investment Plans, transmitted on September 22, 1939, and printed as House Document No. 482, 76th Congress; and Fixed and Semifixed Trusts, transmitted on January 15, 1940, and printed as House Document No. 567, 76th Congress.

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Chapter I

DESCRIPTION, SOURCES OF MATERIAL, AND HISTORY

I. SUBJECT OF THE REPORT AND LEGISLATIVE AUTHORITY

This report on companies issuing face amount installment certificates is supplemental to a general report of the Securities and Exchange Commission on its study of investment trusts and investment companies conducted by the Commission pursuant to Section 30 of the Public Utility Holding Company Act of 1935.¹

II. SOURCES OF MATERIAL AND CONDUCT OF THE STUDY

This report is based substantially on the material and information which the companies furnished to the Commission in reply to a questionnaire prepared by the Commission for this type of investment company. No field study or examination of the books, documents, or records of these companies was made by the Commission in connection with its study of these companies. This material was to some extent supplemented by conferences and discussions with representatives of the companies and through the testimony of witnesses at public examinations. Two such public examinations were held: Investors Syndicate, January 26, 1938; and Fidelity Investment Association, January 28, 1938. It is important to note, therefore, that the analysis of these companies contained in this supplemental report is based almost exclusively upon information supplied to the Commission by the companies, which information has not been independently verified by the Commission's staff.

III. DESCRIPTION OF COMPANIES INCLUDED IN THE REPORT

The companies covered by this report issue and distribute an investment contract or certificate called a face amount installment certificate. Irrespective of their designation, these certificates are, in essence, simply unsecured obligations² of the companies which

¹ See Pt. One, Ch. I, Report on the Study of Investment Trusts and Investment Companies (House Doc. No. 707, 75th Cong.).

² Some of the several states in which this certificate is sold require certain deposits with the appropriate state official, which deposits are supposed to be "trusteed" or "earmarked" for the benefit of the certificate holder residing in each of those states. A discussion of the weaknesses and problems in connection with these deposits will be found in Chapter V, pp. 125 et seq.

issue them to pay a specified sum (called the face amount or maturity value or amount) to the holder at a specified future date (called the maturity date), provided the purchaser, promptly, and without any delinquency, makes all of the payments required by these contracts or certificates. Under certain conditions, after the contract has been in force for a stated period (which varies from one to two years), the holder of the certificate is entitled to receive, prior to the maturity date, a specified amount (surrender value) on the certificate, which is less than the face or maturity amount. The purchaser pays for a certificate either in an initial lump sum or in a series of periodic installments, depending upon the type of certificate. The maturity amount of each certificate is greater than the total sum required to be paid by the certificate holder. Variations of the obligations and privileges of the issuer and of the investor are numerous and will be described in detail hereinafter.³

IV. ORIGIN AND GROWTH OF COMPANIES

This face amount installment certificate was apparently originated in Minnesota in 1894 by Investors Syndicate. Certificates issued by this company were at first sold locally, although a large distribution of this type of security had not been achieved by 1911, when another company of the same type, Fidelity Investment and Loan Association, was incorporated under the laws of West Virginia in that year by a group of commercial bankers in Wheeling, West Virginia. The name of this corporation was later changed to Fidelity Investment Association.

Commencing in 1914, when a special effort was made to increase sales, Investors Syndicate and Fidelity Investment Association grew at a steady rate. In 1925 control of Investors Syndicate was acquired by a new management group which started vigorous sales campaigns and Investors Syndicate thereafter showed a rapid and substantial increase in size. Both Investors Syndicate and Fidelity Investment Association have continued to grow to the present time.

A third company to engage in the business of issuing face amount installment certificates is United Securities Company of Missouri, incorporated under the laws of Missouri in 1923 and having its principal office in Kansas City, Missouri. These three organizations, together with their subsidiaries and affiliates, are the only organizations of substantial size offering the face amount installment investment certificate in the United States.⁴

Table 1 shows the relative size in gross assets of these three organizations at December 31, 1936, and also shows the number of certificates issued, the amount paid in on certificates issued, and the maturity value of certificates issued for the period 1927-1936:

³ The annuity contracts offered by insurance companies have not been included in this study. The annuity contracts issued by life insurance companies have an element of life contingency which is not present in the contracts discussed herein.

⁴ There doubtless are or have been other similar organizations whose distribution of certificates is largely local.

TABLE 1.—*Summary data regarding Investors Syndicate, Fidelity Investment Association, and United Securities Company of Missouri at December 31, 1936*

	Number of certificates issued ^a	Amount paid in on certifi- cates issued ^b	Maturity value of certificates issued ^a	Gross assets of corpora- tion ^c
Investors Syndicate.....	631, 426	\$154, 247, 232	\$1, 171, 205, 850	\$92, 599, 349
Fidelity Investment Association.....	164, 578	72, 974, 345	479, 337, 640	29, 449, 919
United Securities Company of Missouri....	20, 377	669, 218	(^d)	2, 117, 654

^a Including certificates in force Jan. 1, 1927.^b Including cash surrender values of certificates outstanding Jan. 1, 1927.^c This figure includes assets of subsidiaries.^d Figures are lacking.

In view of the predominant position of Investors Syndicate and Fidelity Investment Association in the field this report will consist principally of discussions of those two companies with a summary description of United Securities Company of Missouri. The report as a whole covers the period from 1927 to and including 1936. In certain instances, however, the report includes material which has been obtained as to special aspects of the companies' operations or activities after 1936.⁵ Subsequent to the preparation of this report, which is based almost exclusively on data furnished by the subject companies in response to the Commission's questionnaire, without independent verification of these data by the Commission's staff, Investors Syndicate filed a registration statement under the Securities Act of 1933 for new series of its certificates. In connection with this registration statement the Commission is to receive a substantial amount of new data respecting the financial condition and activities of the Corporation. This new information, heretofore unavailable to the Commission, may modify and expand the material previously furnished by the Corporation, on which this report is based. The analysis contained in Chapter II, hereof, relating to Investors Syndicate, may therefore be in some respects tentative.

⁵ One instance of such material is the information secured by the Commission in connection with its investigation of Fidelity Investment Association with respect to that company's alleged violation of the provisions of the Securities Act of 1933, and this material was used as a basis for an injunction proceeding instituted in the United States District Court for the Eastern District of Michigan against that company in December 1938. The part of the material gathered by this investigation which is part of the public record has been incorporated in this report, either in the text or in Appendix X, p. 197 et seq.

Chapter II

INVESTORS SYNDICATE

I. INCORPORATION

Investors Syndicate, hereinafter referred to as the "Corporation," is engaged in the business of issuing and selling face amount investment certificates of ten and fifteen year maturity periods and of the investment of the funds received from the sale of such certificates. The Corporation was incorporated under the laws of the State of Minnesota on July 10, 1894, as an ordinary business corporation with corporate powers to deal in and with securities of all kinds. The principal office of the Corporation has always been in Minneapolis, Minnesota. At December 31, 1935 the Corporation was authorized to do business in 44 states, the District of Columbia, and several provinces of Canada.¹

At the end of 1914, 20 years after organization, total assets of the Corporation aggregated \$88,000. In that year the management of the Corporation began to organize and intensify its sales efforts, and as a result increased the assets of the Corporation to \$12,500,000 during the next 10 years. In the year 1925 a new management came into control of the Corporation and instituted an aggressive sales policy, which has continued to the present time.² By December 31, 1936 the gross assets of Investors Syndicate, as reported by it, had increased to approximately \$92,500,000.

II. CAPITALIZATION

The capital of Investors Syndicate at December 31, 1936 consisted of 5,362 shares of \$100 par preferred stock, a total of \$536,200 and 3,500 shares of \$100 par common stock, a total of \$350,000 or a total stock capital of \$886,200. The only changes in capitalization during the period from January 1, 1927 to December 31, 1936, arose from the payment of stock dividends consisting of preferred stock of the total par value of \$486,228 and common stock of a total par value of \$300,000.³

¹ Reply to the Commission's questionnaire for Investors Syndicate, Item 17; Public Examination, Investors Syndicate, at 21528-9.

² Public Examination, Investors Syndicate, Crabb's Exhibit B.

³ Reply to the Commission's questionnaire for Investors Syndicate, Items 2 and 14; Public Examination, Investors Syndicate, at 21555-6.

A. Stock Ownership of Investors Syndicate

As has been indicated, Investors Syndicate has only two classes of capital stocks outstanding—\$100 par value common stock and \$100 par preferred stock. The Corporation is controlled by the holders of its common stock, in whom are vested all voting rights. At December 31, 1935 there were 29 holders of the Corporation's common stock, who owned an aggregate of 3,500 shares, the total number of shares outstanding. Of this aggregate amount a total of 2,664½ shares were held by officers and directors of the Corporation and by a company controlled by J. R. Ridgeway, president of the Corporation. The remainder of the outstanding shares were owned by persons who were not officers or directors of the Corporation.

The holders of common stock among the directors at the end of 1935 were as follows: ⁴

Name	Position with Investors Syndicate	Number of shares owned of record
J. R. Ridgeway.....	President and director.....	777
E. E. Crabb.....	Vice president and director.....	229
D. E. Farr.....	do.....	1
C. J. Ryan.....	Vice president.....	4
E. M. Richardson.....	Secretary, treasurer, and director.....	129
King Merritt.....	Director.....	229
Prudential Loan Co.....	Controlled by J. R. Ridgeway.....	1,295½
Total.....		2,664½

There was no substantial change in common-stock ownership in 1936. ⁵

At December 31, 1935 a total of 3,887 shares of \$100 par preferred stock was outstanding, of which 429½ shares were owned by officers and directors of the Corporation and 127½ shares were owned by Prudential Loan Company. In 1936, 1,475 shares of preferred stock were issued as a stock dividend, thereby increasing total outstanding preferred stock to 5,362 shares as of December 31, 1936.

The capital stock of the Corporation, control of which is vested in a few individuals, has never been registered with this Commission under the Securities Act of 1933. There is presently an over-the-counter market for this stock.

B. Brief Description of Securities Issued and Sold to Public

The securities sold to the public are the face amount investment certificates issued by this closely held private corporation. Three types of face amount investment certificates are sold: (1) installment certificates, for which the investor pays in periodic installments (monthly, quarterly, semiannually, or annually) over a period of years and receives at maturity a fixed amount; (2) coupon certificates,

⁴ Reply to the Commission's questionnaire for Investors Syndicate, Item 14.

⁵ There were interfamily transactions involving 1,749 shares, but these transactions did not change the relative holdings.

for which the investor makes a lump-sum payment at the time of purchase and receives interest semiannually at a fixed rate, together with a fixed sum at maturity; and (3) single-payment certificates, for which the investor makes a lump-sum payment at the time of purchase and may receive at maturity, or prior thereto, a face amount representing the sum of the purchase price, plus a sum for compound interest.

The period of maturity for the installment certificate, like the other types, was formerly 10 years, but since 1932 has been 15 years, although the maturity periods of the other two types have remained 10 years. Since 1928 all three types of certificates have carried so-called optional annuity rights at maturity. The holder of the certificate apparently has the right at maturity, at his option, to receive the face or maturity amount of the certificate in installments with interest,⁶ at the stipulated contract rate. The installment type of certificate represents over 95% of all those issued and sold by the Corporation.

C. Type of Investments of the Corporation ⁷

Originally, practically the entire assets of the Corporation were invested in real-estate mortgages. Since the change in control in 1925, however, this policy has been changed several times so that in more recent years the investments of the Corporation have consisted, besides real estate and mortgages, of government bonds, bonds and debentures of corporations, preferred and guaranteed stocks of railroad companies, and preferred stocks of public utilities. In round amounts the assets of the Corporation aggregated \$87,000,000, on a book-value basis, at the end of 1936, apportioned as follows:⁸

Cash	\$2, 400, 000. 00
Investments in securities: ^a	
Canadian securities.....	\$2, 500, 000
Domestic securities.....	19, 500, 000
	<hr/>
	22, 000, 000. 00
Stocks of wholly owned subsidiaries.....	3, 600, 000. 00
First liens on real estate:	
Mortgages guaranteed by F. H. A.....	14, 800, 000
Other first liens.....	34, 000, 000
	<hr/>
	48, 800, 000. 00
Loans on certificates.....	3, 900, 000. 00
Real estate.....	5, 300, 000. 00
Other assets.....	1, 000, 000. 00
	<hr/>
Total.....	\$87, 000, 000. 00

^a Of the total investments in securities, \$3,500,000 represented investments in guaranteed and preferred stocks.

The cash surrender value of certificates outstanding at the end of 1936, together with advance payments by certificate holders—payments in addition to the total requirements for the current contract year—amounted approximately to \$65,300,000. Other contract liabilities and reserves were reported at approximately \$18,300,000, an aggregate of contract liabilities and reserves of \$83,600,000.

⁶ Reply to the Commission's questionnaire for Investors Syndicate, Item 17; Public Examination, Investors Syndicate, at 21528-9.

⁷ See discussion *infra*, Sec. IX, *Management of Assets*, p. 35.

⁸ This figure is for the parent, Investors Syndicate, and does not include assets of the subsidiaries.

D. Employees of the Corporation

At December 31, 1935, the Corporation and its subsidiaries had 495 employees on a salary basis and 2,803 employees on a commission basis only. Of the latter group 100 were listed as part-time employees. At December 31, 1936, the Corporation and its subsidiaries employed 765 persons on salary and 3,201 persons on a commission basis only. Of the latter group 115 were listed as part-time employees.⁹

As of December 31, 1935, the Corporation maintained directly or through subsidiaries a total of 68 branch offices in the United States and Canada, of which 50 were agency offices for the solicitation and sale of investment certificates and 18 were offices maintained to carry on the appraisal of real estate, in connection with mortgage loans, and the like. The agency offices are maintained by the divisional and agency managers and the branch mortgage loan offices are maintained by the Corporation.¹⁰

III. CONTROL AND AFFILIATIONS

A. Subsidiaries ¹¹

Investors Syndicate had 16 wholly-owned subsidiary corporations at the end of 1936. The principal functions of these corporations are: (1) to act as mortgage broker; (2) to supervise and promote the sale of the certificates; (3) to issue and sell mortgage participation installment certificates in certain States; (4) to prevent others from appropriating the name of the Corporation; (5) to act as insurance agency; (6) to act as real estate and mortgage company. Of these subsidiaries five were of active importance to the Corporation: Investors Syndicate Title & Guaranty Company; Installment Securities Agency, Inc.; Southwestern Mortgage Investment Corporation; Southern Mortgage Loan Corporation; and Jefferson Mortgage Company.¹²

1. INVESTORS SYNDICATE TITLE & GUARANTY COMPANY

On April 23, 1928 Investors Syndicate Title & Guaranty Company was incorporated under the laws of New York¹³ to conduct a title and guaranty business.¹⁴ Its original corporate name was Commercial Title & Guaranty Company, which was changed to its present title on June 20, 1930, upon its acquisition by Investors Syndicate.¹⁵ Commercial Title & Guaranty Company was apparently dormant at the date of its acquisition by Investors Syndicate. Since June 1930

⁹ See discussion *infra*, Sec. V, *Sale of Certificates*, p. 15.

¹⁰ *Ibid.*

¹¹ Public Examination, Investors Syndicate, at 21529 et seq.

¹² The other subsidiaries were incorporated merely for the purpose of preventing the appropriation of the name of Investors Syndicate in certain states, or were inactive at the end of 1936.

¹³ L. 1909. Ch. 33; McKinney's Consolidated Laws of New York, Book 27, Art. 5, Sec. 170. Cahill's Consolidated Laws of New York, 1930, Ch. 30, Sec. 170.

¹⁴ Reply to the Commission's questionnaire for Investors Syndicate Title & Guaranty Company, Item 1, Exhibit 1.

¹⁵ *Id.*, Items 1 and 17.

Investors Syndicate Title & Guaranty Company has been engaged in issuing and selling its installment mortgage participation certificates within New York State, the parent Investors Syndicate having suspended its operations in that state since the acquisition of the subsidiary.¹⁶

This subsidiary company is also qualified under foreign corporation statutes to do business in Iowa¹⁷ and California,¹⁸ although apparently it has never carried on any business in California. At December 31, 1936 its authorized capital stock consisted of 2,500 shares of \$100 par common stock, all of which were outstanding and owned by Investors Syndicate except the directors' qualifying shares.

The investment certificates of this subsidiary vest in the holder an undivided interest in certain first mortgages and deeds of trust on deposit with a trustee. Total assets of this subsidiary company as stated in a balance sheet for December 31, 1936, were \$852,645. However, the balance sheet shows first mortgages and deeds of trust on deposit aggregating \$3,924,365, against which and deducted therefrom were outstanding participation certificates in the amount of \$3,694,604, leaving a net of \$229,761. The gross assets of this subsidiary company were therefore \$4,547,249 at the end of 1936.

2. INSTALLMENT SECURITIES AGENCY, INC.

Installment Securities Agency, Inc., was organized under the general corporation statutes of Minnesota in September 1927. It is a wholly-owned subsidiary of Investors Syndicate. Until 1934 the principal business of this company was that of a general agency to promote and carry on the sale of the investment certificates of the parent company. Since June 1934, however, the solicitors and salesmen have been employed directly by the parent company, and the stated activities of this company have been advertising for the sale of certificates of Investors Syndicate and Investors Syndicate Title & Guaranty Company, and to the administration of certain matters pertaining to field sales agencies.

3. SOUTHWESTERN MORTGAGE INVESTMENT CORPORATION AND SOUTHERN MORTGAGE LOAN CORPORATION

Southwestern Mortgage Investment Corporation and Southern Mortgage Loan Corporation were both incorporated under the laws of the State of Delaware in July 1933. The principal business of the former is that of a real estate company, and that of the latter a mortgage company. They are both wholly-owned subsidiaries of

¹⁶ Certificates issued by Investors Syndicate Title & Guaranty Company prior to September 1935 were designated "Trusted Participation Certificates—Guaranteed"; those issued since that time as "Trusted Participation Certificates." In 1930 the parent, Investors Syndicate, had encountered some difficulty with the regulatory authorities in New York and the subsidiary was acquired to facilitate operations in New York. See the reply to the Commission's questionnaire for Investors Syndicate.

¹⁷ Qualified in August 1932. (See the reply to the Commission's questionnaire for Investors Syndicate Title & Guaranty Company, Item 18.)

¹⁸ Qualified in April 1933. (Ibid.)

Investors Syndicate and were organized to facilitate a loan to the parent company from the Reconstruction Finance Corporation.¹⁹

At December 31, 1936 Southwestern Mortgage Investment Corporation had a stock capital of \$500,000. At the same date Southern Mortgage Loan Company had a stock capital of \$500,000, of which \$247,000 was represented by stock owned by Southwestern Mortgage Investment Corporation.

4. JEFFERSON MORTGAGE COMPANY

Jefferson Mortgage Company was incorporated in May 1927 under the laws of the State of Alabama. Its principal business is real estate and mortgage brokerage, which it carries on in the States of Alabama and Georgia. At December 31, 1936 it had a capital of \$3,000. Its earned surplus at this date was \$52,078.

The aggregate assets of Jefferson Mortgage Company, Southwestern Mortgage Investment Corporation, and Southern Mortgage Loan Company at December 31, 1936, totaled \$4,990,000 and consisted almost entirely of real estate and real estate mortgages.²⁰

IV. TYPE OF CERTIFICATES SOLD

The investment certificates issued and sold by the Corporation are in essence contracts between the Corporation and the investors, whereby the investors agree to make certain payments, either in an initial lump sum or in installments over a designated period of time, to the Corporation; and in consideration of such payment or payments the Corporation agrees to pay to the investor a specified sum at a specified future date, usually termed the face or maturity amount of the contract or certificate. The installment contracts or certificates provide that after the attainment of cash surrender values, which according to series may vary from one to two years from the date of issuance (assuming all installments are paid at their due dates), the certificate holder shall be entitled to discontinue his payments at any time prior to the maturity date of the certificate and to receive, upon surrender of the certificate, a sum in cash computed on a rate increasing with the age of the certificate. This variable cash amount available prior to maturity is ordinarily called the cash surrender value. In the certificates which were being issued and sold by the Corporation at the end of 1936, a surrender value was first attained only after all required installment payments for the first year had been made and the full period paid for had elapsed. Unless all the first year installments were paid, and the anniversary dates reached, the certificate had no cash surrender value according to its terms, i. e., the holder did not receive back any portion of the money he had paid on the certificate. Some certificates previously issued and sold by the Corporation required the payment of installments for 18 months to 2 years before they attained a cash surrender value. In this connection it will be noted that over 95% of all certificates issued and sold by the Corporation have been and are of the installment type.

¹⁹ For detailed discussion of the loan see *infra*, Sec. IX, B, p. 36.

²⁰ A copy of a consolidated balance sheet of these 3 subsidiaries, submitted by Investors Syndicate to the Commission in reply to the questionnaire, will be found in Appendix A-2, p. 138.

Each of the installment contracts states or calls for an implicit yield which in essence is the difference between the maturity amount of the certificate and the amount required to be paid by the holder, divided by the number of years required to mature the certificate. The actual improvement rate is that percentage of increase annually on anniversary dates of the then cash surrender value and contract and certificate reserves, so that the next year's cash surrender value, or maturity value, is available on required dates. The implicit yield rate is the percentage per annum of the total of the required installment payments per annum which at the expiration of the full term of the contract will equal the difference in amount between the total installment payments and the agreed maturity or face amount. This implicit yield varied with the several series of contracts or certificates. Naturally, since the Corporation takes into income a substantial amount of the installment payments in the first two years of the contracts, the actual improvement rate which the Corporation is obligated to apply, when the contract holder makes all his payments when due and as required, is greater than the implicit yield rate based on the total of installment payments.

The holders of the Coupon Certificates and Coupon and Annuity Certificates are paid a sum semiannually as interest, until maturity upon presentation of coupons. The holders of Single Payment Certificates receive an interest accumulation plus their original payment, at maturity.

A. Total Face Amount of Certificates Outstanding

The total face or maturity amount of the investment certificates or contracts of the parent corporation, outstanding December 31, 1936, aggregated \$625,449,067; that is, if the holders of these outstanding certificates made the payments required by these certificates up to their maturity date the Corporation would be obligated to pay to these certificate holders upon maturity an aggregate of \$625,449,067. It must be recalled that in the installment certificate the amount to be paid by the contract holders is not equal to this aggregate maturity value. These certificates, as reported by the Corporation, had a demand value at that date of \$65,229,136 (cash surrender values plus advance payments);²¹ that is, if the holders of certificates outstanding at the end of 1936 all surrendered their certificates on that date in accordance with the terms of the certificates, these holders would receive an aggregate of only \$65,229,136, the amount of the cash surrender values plus advance payments. So too, it must be recalled that this aggregate cash surrender value is substantially less than the amount, \$94,131,438, actually paid in by these certificate holders up to December 31, 1936. As of December 31, 1936, the certificate or contract liabilities and reserves, as maintained by the Corporation under its own formulas,

²¹ These amounts are discussed *infra*, Sec. VIII, *Contract Liabilities and Reserves*, p. 32.

devised by it, were apportioned among four accounts, with titles as furnished by the corporation as follows:

Certificate cash surrender values-----	\$58, 833, 196
Advance payments liability-----	6, 395, 939
Contingent liability reserve-----	11, 661, 260
Certificate reserve-----	6, 681, 043
Total-----	\$83, 571, 438

It must be emphasized that the adequacy of the above described reserves and the soundness of the Corporation's reserve formulas have not been established. There are no legal reserves required to be maintained by the Corporation under any state statutes such as are required generally of insurance companies in all states.

B. Nature and Conditions of Certificates

The investment certificates issued and sold by Investors Syndicate are, as previously stated, of three general types: installment certificates, coupon certificates, and single payment certificates.

As previously noted over 95% of all the certificates issued and sold by the Corporation are of the installment type.

1. INSTALLMENT CERTIFICATES

The installment certificates are not interest bearing contracts. The purchaser of the installment certificate undertakes to pay to the Corporation in periodic installments specified sums of money, for which, if he fully performs, he is to receive from the Corporation at the attainment of an ascertainable maturity date, the face amount of the contract. Up to August 1932 the term of the certificates of this type was 10 years; since this date the term has been 15 years.

The installment certificates contain a schedule of annual cash surrender values and loan values (the amount up to which the holder may borrow from the Corporation on his certificate) applicable prior to maturity. The surrender and maximum loan values are identical and increase in amount from year to year as the certificate improves. For the certificates issued at the end of 1936, the investor had a cash surrender or loan value of about 36 $\frac{2}{3}$ % of his payments at the end of the first year and about 56% at the end of the second year. Not until the required payments have been made and until the seventh effective year does the certificate contain a cash surrender value or loan value equal to the amount paid in, on an annual payment basis, by the certificate holder. For the certificates issued prior to 1928, there were neither loan nor cash surrender values until the payment of two full years' installments. From January 1928 to February 1936 the certificates being offered first attained cash surrender and loan values after the completion of 18 months' payments by the holders. The certificates being sold since February 1936 attained their first cash surrender and loan values after the completion of one year's payment by the holders. The percentages used above are based upon annual payments in advance by certificate holders. Since most contracts are paid for by their holders on less than the annual (semianually, quarterly, or monthly) basis, however, the point at which the

investor has a cash surrender value equal to as much as he has paid in, is in the majority of cases at the end of the eighth instead of the seventh year, and on this basis the above percentages of attained cash surrender and maximum loan values would be substantially diminished. Contracts terminated prior to attainment of cash surrender value result in total loss to the contract holders. All installment contracts which lapse before attainment of cash surrender value may be subsequently reinstated, with credit for payments previously made, by conversion into a contract of the series presently being issued, subject to a reinstatement charge of \$1 per certificate.

2. COUPON CERTIFICATES

The purchaser of the coupon certificates pays the full purchase price to the Corporation at the time of issuance of the certificate, and at the end of a prescribed period receives back a fixed sum identical with the initial payment. The certificate has coupons attached which upon presentation semiannually entitle the holder to receive interest at stipulated rates. In addition, the holder has the apparent option, under the terms of the contract, of converting the face amount into an annuity by receiving the maturity amount in prescribed installment payments with interest. Certificates of this type were typically designated "Coupon and Annuity Certificates." However, the Corporation, by exercising the call provision in the contract, may, and in practice does, defeat the election by contract holders of the optional annuity settlement. Holders of this type of certificate, like holders of the installment type, may surrender their certificates before maturity and receive back from the Corporation the principal paid in less the surrender charge of 1% of the principal amount.

3. SINGLE PAYMENT CERTIFICATES

The purchaser of the single payment certificate, like the purchaser of the coupon certificate, pays the full purchase price to the Corporation at the time the certificate is issued. At the end of a stipulated period the holder receives back a fixed amount representing the amount paid in plus accumulated interest. In the certificates of this type being issued at the end of 1936, the interest accumulated at the rate of 3% compounded semiannually, and the maturity period was 10 years. The cash surrender and maximum loan values of this type of certificate are identical and increase with the age of the certificate. Single payment certificates issued since 1928 have borne optional maturity settlement rights subject to defeasance by the call provision also contained in the contract. Likewise installment certificates sold since January 1928, except Series F, sales of which began in February 1936, have similar provisions of both call and optional settlement at maturity.

4. CERTIFICATES SOLD IN NEW YORK

The certificate sold in the State of New York, and also in Iowa, is issued by Investors Syndicate Title & Guaranty Company. The certificate is of the installment type, of fixed maturity amount, and

represents participations in deposits of real estate mortgages deposited with a trustee.²²

Investors Syndicate Title & Guaranty Company agrees to pay to the holder of the certificate a fixed sum at maturity; and also guarantees his undivided interest in the principal of deposited securities and interest thereon at a stipulated rate per annum. The parent company, Investors Syndicate, also endorses, unqualifiedly, the deposited collateral as to principal and interest. The certificate also gives the holder the right to participate, subject to certain deductions, to the extent of 75% in excess earnings on the deposited securities over the stipulated interest rate.²³ The certificates have definite cash surrender values prior to maturity, but no stated loan values. However, the parent corporation makes loans to the holders of these certificates against the certificates of the subsidiary.

C. Covenants in Certificates for Assets Maintenance

The certificates sold by Investors Syndicate and its New York subsidiary are sometimes referred to as "guaranteed" face amount certificates, which may be misleading since many investors regard a guarantee as an obligation of a third party.²⁴ However, all certificates issued by the Corporation contain covenants purporting to maintain a certain amount of assets proportionate to the liability of the issuer on the outstanding certificates.²⁵

The covenant selected as typically contained in certificates other than those sold in New York State is as follows: ²⁶

"The company agrees to keep and maintain at all times first mortgages or deeds of trust on improved real estate, cash, and government bonds in an amount equal to at least \$110 for each \$100 of its liability hereunder."

The covenant found in the certificates of the "F" series, being issued at December 31, 1936, is as follows: ²⁷

"ARTICLE 1. Security.—The Company agrees to maintain cash and investments in first mortgages and first deeds of trust on improved real estate, in government bonds, state bonds, municipal bonds, obligations issued or guaranteed in whole or in part by the United States Government or by a government chartered institution or agency, and/or in assets of the kind which life-insurance companies are permitted by the laws of the State of New York to hold, aggregating in amount not less than \$110 for each \$100 of its liability hereunder and under all other series-F contracts issued by it, said liability being the optional-settlement

²² At December 31, 1937 the trustee was the Midland National Bank and Trust Company of Minneapolis, Minnesota. (See the reply to the Commission's questionnaire for Investors Syndicate, Item 21.)

²³ At one time the participation of the New York holders in such excess earnings was 80%. This is no longer true; all holders now receive a 75% participation.

²⁴ Although the Corporation may guarantee the face amount its guarantee is no better than its promise to pay. There is no suretyship undertaking by a third person.

²⁵ As previously indicated, statutes of some states required actual deposits of specified assets, but these requirements are independent of the issuer's covenant to the investors.

²⁶ Reply to the Commission's questionnaire for Investors Syndicate, Item 22.

²⁷ Ibid.

amounts as shown in Article 12 less the amount owing on outstanding loans made hereunder.”²⁸

The Corporation represents that the covenants provide an investment yardstick as to classes and amounts of securities, and do not impose any obligation to segregate, trustee, or otherwise specifically apply any specific funds or assets to any particular certificate, certificates, or series of certificates; but that they permit by clear implication, the commingling of funds for all certificates, irrespective of series. However, as required by various state statutes or regulations thereunder, deposits of cash and securities are made, as and to the extent required, with approved state officials or with trustees of their designations. The basis, nature and amount of such deposits are shown for each state under Chapter V, Section C, *infra*.

The language of the covenants is susceptible of possible misunderstanding and therefore may convey exaggerated impressions of safety and security to some purchasers of the certificates.

The extent to which these covenants have been observed is discussed herein in Section XI, K, *infra*.

V. SALE OF CERTIFICATES

A. Amount of Certificates Sold

The certificates or investment contracts issued by the Corporation, each representing maturity amounts of \$2,500, or multiples thereof, as well as the half units, representing a maturity amount of \$1,250,²⁹ are distributed through a continuous selling campaign. The salesmen and solicitors of the campaign are paid on a commission basis only, a few of whom work on a part-time basis.

E. E. Crabb, executive vice president of Investors Syndicate, testified:³⁰

“A. * * * This necessity for solicitation has been pointed out. These contracts are not entered into except through solicitation. It is a matter of creating the business, and the service performed by the agency for us in developing this business and in encouraging people to enter into a program that they probably would not otherwise adopt at all, must be appreciated and understood.”

The number of certificates sold annually from January 1, 1927 to December 31, 1936, the payments to the Corporation by the purchasers thereof and the total maturity amount of the certificates outstanding at January 1, 1927 (excluding data on Investors Syndicate Title & Guaranty Company, the New York subsidiary) are shown in Table 2.³¹

²⁸ The type of covenant contained in the mortgage participation certificate sold in the State of New York by the New York subsidiary is as follows (reply to the Commission's questionnaire for Investors Syndicate Title & Guaranty Company, Item 22):

“The securities in which this Subscriber owns an Undivided Interest shall at all times consist of bonds, or notes secured by first mortgages or first deeds of trust on improved real estate qualified for the investment of such funds under the laws of the State of New York governing Title and Mortgage Guaranty Corporations.”

²⁹ In the past the maturity value of the certificates has varied from \$1,000 to \$2,600. (Reply to the Commission's questionnaire for Investors Syndicate.)

³⁰ Public Examination, Investors Syndicate, at 21593.

³¹ Based on the reply to the Commission's questionnaire for Investors Syndicate, particularly Item 31.

TABLE 2.—*Number of certificates sold by Investors Syndicate, annually, 1927–1936*

Year	Number of certificates	Maturity amount ^a		Payments by certificate holders
		Total	Average per certificate	
1927.....	27,240	\$40,267,400	\$1,478	\$5,603,985
1928.....	34,126	77,786,200	2,279	7,560,957
1929.....	65,601	105,185,800	1,603	10,466,390
1930.....	56,396	96,835,700	1,717	13,104,236
1931.....	55,401	81,332,150	1,468	14,346,976
1932.....	56,666	81,359,150	1,436	12,775,036
1933.....	36,978	73,900,000	1,998	11,890,307
1934.....	58,589	117,796,650	2,011	14,695,010
1935.....	70,142	152,469,700	2,174	19,250,230
1936.....	66,817	167,337,300	2,504	24,022,392
Total.....	527,956	^b 994,270,050	1,883	133,715,719
In force Jan. 1, 1927.....	73,427	106,437,500	-----	^c 15,193,157
Grand total.....	601,383	1,100,707,550	-----	148,908,876

^a Prior to 1932 certificates were of a unit maturity amount of \$1,000 or in multiples thereof. In that year the amount was changed to \$2,600. In 1935 the amount was changed to \$2,500.

^b Of this amount, \$17,036,045 represents single payment certificates and \$977,234,005 represents installment certificates.

^c This figure is the cash surrender value and amount of other certificate reserves of certificates at this date as shown in Moody's Manual, Banks, etc., 1928, p. 2763.

It must be noted that these figures represent the aggregate of the number and face amount of, and payments on all certificates sold during the indicated years. Of course, during this period a substantial number of certificates were terminated before maturity either through lapses, withdrawals, defaults, or surrender. So, too, a substantial amount of the aggregate payments made on these certificates was repaid in the form of surrender values or loan values and a substantial amount of these aggregate payments was "lost" by investors by lapses and defaults and by surrenders or withdrawals at a time when the surrender or loan value did not equal or reach the amount paid in by the holder.³² To the condition of lapses and surrenders, the depression of the period no doubt contributed to a considerable degree.

Table 3 indicates the same data for the Corporation's New York subsidiary, Investors Syndicate Title & Guaranty Company, from 1930, the date it began business, through December 31, 1936:³³

TABLE 3.—*Number of certificates sold by Investors Syndicate Title & Guaranty Company, 1930–1936*

Year	Number of certificates	Maturity amount		Payments by certificate holders
		Total	Average per certificate	
1930.....	2,521	\$5,117,625	\$2,030	\$133,890
1931.....	5,281	10,128,775	1,918	643,210
1932.....	6,535	16,418,900	2,512	930,523
1933.....	4,137	9,846,275	2,380	921,057
1934.....	4,804	11,612,450	2,417	1,196,900
1935.....	3,688	9,108,275	2,470	1,512,776
1936.....	3,077	8,266,000	-----	-----
Total.....	30,043	70,498,300	2,310	5,338,356

³² For more detailed discussion see *infra*, Sec. XI, *The Experience of Investors*, p. 54.

³³ Reply to the Commission's questionnaire for Investors Syndicate Title & Guaranty Company, Item 31.

Similar to the figures given above for the parent company, Investors Syndicate, this table does not adjust for surrenders and other terminations of the certificates sold during this period.

B. Sales Organization

The sales organization of the Corporation consisted of over 3,200 persons in 1936, and is under the direction and control of a general manager whose headquarters are at the home office of the Corporation in Minneapolis. The territory within the United States and in part of Canada is divided into geographical divisions, each supervised by a division manager, and each division is in turn grouped into territories whose activities center around branch offices, supervised by agency managers.³⁴ There are 28 divisional managers,³⁵ and 50 agency managers.³⁶

The actual solicitation of business, i. e., the selling of certificates, is done by the solicitors. The total number of solicitors during 1935 was 2,803, of whom 100 were listed as part-time employees, and the total number during 1936 was 3,201, of whom 115 were listed as part-time employees. All these salesmen were paid commissions on the initial and a limited number of subsequent installment payments by the investors on a fixed basis. There were no salaried solicitors.

From January 1, 1928 to about June 30, 1934 applications were solicited by solicitors under contract with Installment Securities Agency, Incorporated, a wholly-owned subsidiary of Investors Syndicate. Since June 30, 1934, however, the sales agency has abandoned this function, and the solicitors have been employed by the Corporation directly.³⁷

There is a very large turnover in the force of solicitors. For example, 2,800 new solicitors were employed in the calendar year 1935 and 3,151 new solicitors in 1936; during the year 1935, 2,371 solicitors left the employ of the company, while in 1936, 2,638 solicitors left, leaving net additions to the sales staff of 429 and 513 for those respec-

³⁴ Reply to the Commission's questionnaire for Investors Syndicate, Item 13; Public Examination, Investors Syndicate, at 21529 et seq.

³⁵ As of June 30, 1938, the offices of the divisional managers were located in Birmingham, San Francisco, Memphis, Phoenix, New Haven, Wilmington (Delaware), Atlanta, Spokane, Chicago, Des Moines, Webster Groves (Missouri), Kansas City (Missouri), Roanoke, Detroit, Boston, Minneapolis (2), Newark, Philadelphia, Cleveland, Columbus, Portland (Oregon), Harrisburg, Houston, Dallas, Vancouver (British Columbia), Toronto (Ontario), and Montreal (Quebec).

³⁶ As of December 31, 1937 the branch offices were located in the following cities:

Des Moines.	Butte.	Winnipeg.
Kansas City, Mo.	Columbia, S. C.	Syracuse.
Jackson, Miss.	Buffalo.	Baltimore.
Denver.	New York City.	Nashville.
Los Angeles.	Toronto.	St. Paul.
San Francisco.	Philadelphia.	Newark.
Richmond.	Calgary, Alberta.	Seattle.
Charleston, W. Va.	Harrisburg, Pa.	Grand Rapids, Mich.
St. Louis.	Birmingham.	Jacksonville.
Raleigh.	Washington.	Chicago.
Providence.	Oklahoma City.	Charlotte.
Memphis, Tenn.	Vancouver, British Columbia.	Springfield, Mass.
Dallas.	New Haven.	Pittsburgh.
Houston.	Indianapolis.	New Orleans.
Salt Lake City.	Louisville.	Portland, Oreg.
Atlanta.	Detroit.	Trenton.
Boston.	Montreal.	

³⁷ Reply to the Commission's questionnaire for Investors Syndicate, Items 27 and 28.

tive years. The tenure of service of active sales representatives at September 30, 1937, was as follows: ³⁸

Appointed	Length of service	Number	Percent of total
After Oct. 1, 1936.....	Less than 1 year.....	1, 520	50.0
Oct. 1, 1935 to Oct. 1, 1936.....	1 to 2 years.....	635	20.8
Oct. 1, 1934 to Oct. 1, 1935.....	2 to 3 years.....	363	11.9
Oct. 1, 1933 to Oct. 1, 1934.....	3 to 4 years.....	172	5.7
Oct. 1, 1932 to Oct. 1, 1933.....	4 to 5 years.....	102	3.4
Oct. 1, 1931 to Oct. 1, 1932.....	5 years and over.....	255	8.2
Total.....		3, 047	100.0

Over 70% of the sales force worked for the Corporation (or its subsidiaries) less than two years, and 82.7% worked for the Corporation (or its subsidiaries) less than three years.

The Corporation has employed many types of persons as salesmen. Salesmen are recruited from a variety of antecedent occupations. Former commercial, industrial, and securities salesmen, former school teachers, and the like, appear to have joined the Corporation's sales force.³⁹ The stated general rule is that more business is produced by salesmen with sales experience prior to their employment by the Corporation than by any other type of salesman.

Prospects are generally secured from new certificate holders. Efforts are ordinarily made to secure from each new investor a list of names of friends and acquaintances (10 if possible) who might be approached as potential investors in the certificates. One of the principal objectives of the sales organization is that each salesman shall at all times be equipped with a list of at least 100 "live" prospects. Efforts are usually made to have the new certificate holder personally introduce the salesman to suggested prospects by means of a card, a note, or telephone call.⁴⁰

Each salesman is equipped with a "sales kit"—a collection of literature, propaganda, and devices of various kinds which are used on the prospects.

Some investors, or certificate holders, do not understand either the nature of the certificate or the privileges and duties of the Corporation or of themselves as set forth in the certificate. This is in large part due to express or implied misrepresentations of salesmen, or perhaps to lack of understanding on the part of the salesmen themselves. A number of complaints received by the Commission respecting the Corporation indicated that the salesman had told the certificate holder that an investment in the certificate of the Corporation was just like a deposit in "a savings bank; you can get your money out at any time."⁴¹

³⁸ Ibid.

³⁹ Id., Item 28.

⁴⁰ Ibid.

⁴¹ Letters to this effect were received from residents of Massachusetts, Kentucky, Illinois, Michigan, Pennsylvania, New Jersey, Connecticut, North Carolina, Maryland, Alabama, Iowa, and Montana. E. E. Crabb, vice president of the Corporation, testified (Public Examination, Investors Syndicate, at 21571):

"A. * * * A savings bank occupies an entirely different field and we are not attempting to compare our installment investment contract with a savings account."

C. Selling Commissions and Other Procurement Costs

The commissions paid by the Corporation to its salesmen, as well as other so-called procurement costs, are taken by the Corporation out of the payments by the certificate holders during the first and second years after the issuance of the certificates. It is this deduction of the salesman's entire commission and other so-called procurement costs—the sales load—from the earlier payments made by the purchaser which makes the surrender value of the certificate during the first two years so much less than the total amount paid by the purchaser during these years. The total of commissions paid and other so-called procurement costs has varied from time to time. The combined totals of the expenses charged by the Corporation against payments by certificate holders were from 47.3% of the total of two years paid installments for Certificate Series #50,000 and #200,000, to 43.2% for Series A. For Series B, D, and F such deductions were maintained at approximately the same level as for Series #50,000 and #200,000. In other words, out of the total installment payments made by certificate holders for the first two years, Investors Syndicate deducts almost 50% of these payments for salesmen's commissions and other expenses.

On a cumulative basis for the first two years of the life of the certificate, the commission received by salesmen, expressed in percentage of the total payments made by certificate holders during these two years, varied from 21.9% for Series B to 23.6% for Series #50,000 and Series #200,000. The percentage figures for other series were as follows: Series A, 22.3%; Series D, 22.8%; and Series F, 22.1%. In other words, the salesmen receive almost one-fourth of the total payments made by investors on their installment certificates the first two years.

On certificates lapsed before the attainment of cash surrender values—one year, eighteen months or two years, according to series—holders lose all payments made by them, subject to reinstatement rights. No certificate of any series, except Series F, had any cash surrender value during the first year; all installment payments were completely absorbed by commissions and other expenses charged by the Corporation. Therefore, if a certificate holder makes the first 11 monthly payments and then ceases making the payments or decides to terminate his certificate, the holder under the terms of the contract does not receive back any portion of the money paid by him on the certificate. Of course a certificate holder may, by the payment of additional sums, receive credit for the sums he has paid in on a new certificate.

Table 4, representing the distribution of the payments by the certificate holders, shows the amounts allocated to cash surrender values, selling commissions, and other expenses. This table is divided into two parts, one part showing dollar amounts and the other part the percentage of payments made. The table has been limited to the first two years of the life of the certificate, since in subsequent years the annual increase in cash surrender values equaled or exceeded the amount of the annual installment payments.⁴²

⁴² Reply to the Commission's questionnaire for Investors Syndicate, Item 29 and derived from supplementary information supplied the Commission.

TABLE 4.—*Distribution of installment payments on certificates issued by Investors Syndicate*

Series	Denom-ination ^a	Period during which sold	First year				Second year (cumulative)			
			Cash surren-der value ^b	Selling com-mis-sions ^c	Other ex-penses ^d	Total install-ments ^e	Cash surren-der value ^b	Selling com-mis-sions ^c	Other ex-penses ^d	Total install-ments ^e
	<i>Dollars</i>		<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>	<i>Dollars</i>
50,000.....	1,000	1927-28	0	35	39	74	78	35	35	148
200,000.....	1,000	1928-30	0	35	39	74	78	35	35	148
A.....	1,000	1930-32	0	31	43	74	84	33	31	148
B.....	2,600	1932-35	0	41	73	114	132	50	46	228
D.....	2,500	1935-36	0	46	70	116	132	53	47	232
F.....	2,500	1936 on	44	45	31	120	134	53	53	240
			<i>Percent</i>	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>
50,000.....			0	47.3	52.7	100.0	52.7	23.6	23.7	100.0
200,000.....			0	47.3	52.7	100.0	52.7	23.6	23.7	100.0
A.....			0	41.9	58.1	100.0	56.8	22.3	20.9	100.0
B.....			0	30.7	69.3	100.0	57.9	21.9	20.2	100.0
D.....			0	39.6	60.4	100.0	56.9	22.8	20.3	100.0
F.....			36.7	37.5	25.8	100.0	55.8	22.1	22.1	100.0

^a Face or maturity amount of certificate.^b Cash surrender value or amount to which holder is entitled upon surrender of his certificate to the Corporation.^c Salesmen's commissions deducted.^d Other expenses deducted. Included are certificate reserves other than cash surrender value reserves for series F in first year and all series in second year, to wit:

Series:	#50,000	#200,000	A	B	D	F
1st year	\$14	\$14	\$14	\$44	\$28	\$5
2nd year	32	32	19	18	8	10

Expense deductions, other than commissions, which were \$25 for each of the first two series and \$29 for the third series in the first year became, cumulatively, \$3 and \$12, respectively, in the second year were reduced \$22 and \$17, respectively.

^e Total amount paid by holders of certificate at annual payment rates. Most installments are paid on a monthly basis, which is about 5% higher than payment on an annual basis.

It is manifest from this table that, with respect to the certificates which were sold by Investors Syndicate during the years 1927 to 1936 (#50,000 series to Series D), the first-year installment payments aggregated from \$74 to \$116; yet, if the holder of one of these certificates surrendered his certificate or permitted the certificate to lapse at the end of the first year, he did not receive back any portion of money paid by him. The entire first-year payments were absorbed by selling commissions or taken into income to cover so-called other acquisition or procurement costs. In other words, 100% of his payments were "lost" to him, unless he later availed himself of his reinstatement rights by renewing and continuing installment payments. For the first two years his payments on the certificates which were sold during the period 1927-1936 aggregated from \$148 to \$232; yet, if he surrendered the certificate at the end of the second year, he received back only from \$78 to \$132 from the company. The remaining \$70 to \$100, or approximately 42% to 47% of his payments for the first two years, was absorbed by selling commissions or taken into income to cover so-called other acquisition or procurement costs and was "lost" to the investor.

The two years' (cumulative) percentage relations of selling commissions and of other so-called procurement costs to the maturity amounts or denominations of certificates of the several series are as follows:

Percent of maturity amount

Series	Unit	Total amount payable or required on annual basis	Selling commission	Other "procurement costs"	Total
			<i>Percent</i>	<i>Percent</i>	<i>Percent</i>
No. 50,000-----	\$1,000	\$740	3.5	3.5	7.0
No. 200,000-----	1,000	740	3.5	3.5	7.0
A. ⁴³ -----	1,000	740	3.3	3.1	6.4
B.-----	2,600	1,710	1.9	1.8	3.7
D.-----	2,500	1,740	2.1	1.9	4.0
F.-----	2,500	1,800	2.1	2.1	4.2

Neither the installment certificates nor the single payment certificates of Investors Syndicate provide for any specific expense allowance or service charge against the payments by certificate holders.⁴³ The certificates contain a schedule of available cash surrender values prior to maturity. The coupon certificates further provide that the holder may elect, at any time prior to maturity, to receive in one sum the amount at such time of the principal,⁴⁴ less any principal payment which may have been made on the certificate, plus accrued interest less a liquidating charge of 1% of such principal.

In February 1936 the Corporation issued a new series of installment certificates (Series F) and single-payment certificates (Series F) with a maturity value or face amount of \$2,500 with an implicit yield of 4% compounded annually, instead of 4½% compounded annually as theretofore.⁴⁵ The certificates being sold at the end of 1936 were, therefore, those with a maturity amount of \$2,500, full certificates, and \$1,250, half certificates. Series F called for aggregate installment payments on a monthly basis of \$126 and on an annual basis of \$120 for the first year on the full \$2,500 contract. Upon surrender of the certificate at the end of the first year the certificate holder received back only \$44; the certificate holder lost \$76 or approximately 63% of the monies he paid on his certificate on an annual basis, or \$82 or 65% on a monthly basis. With respect to the first two years' installment payments aggregating \$240, upon surrender of the certificate at the end of these two years the holder received back only \$134; he lost \$106 or approximately 44% of the monies he paid on his certificate on an annual payment basis. On a monthly basis he paid \$252, received back only \$134 and thus lost \$118 or 46.5% of the monies he paid in. It is recalled that most certificate holders paid on a monthly basis.

⁴³ Reply to the Commission's questionnaire for Investors Syndicate, Item 30.

⁴⁴ Generally such certificates provide for payment of face or principal amount at the end of ten years (interim interest payable semiannually); or upon election at any time by holders, for payment in equal annual amounts (principal and interest) for any number of years from one to twenty.

⁴⁵ Reply to the Commission's questionnaire for Investors Syndicate, Item 22. This improvement rate is based on the assumption that the full amount of certificate holders' payments will be productive. However, since a substantial part of these payments are deducted and is therefore not productive, the effective improvement rate is much higher. See discussion, Sec. IV, B, p. 12.

The selling commissions on these Series F certificates are as follows:⁴⁶

Certificate	Total commissions	Salesman	Agency manager	Division manager
Full unit, \$2,500.....	\$52.50	\$37.50	\$9.00	\$6.00
Half unit, \$1,250.....	24.50	17.50	4.00	3.00

On a basis of payments by certificate holders in monthly installments, the commissions paid to the agency manager out of such installments are completed in the eighth month and for the division manager in the fifth and sixth month for the full and half units, respectively.

Payments to salesmen are made in 20 monthly installments, \$3.50 per month for 7 months and \$1.00 per month thereafter for 13 months for full units; and \$1.50 per month for 5 months; \$1.75 for 2 months and 50 cents thereafter for thirteen months for the half units.

Expressed in percentages of the maturity amounts of the certificates for full units of \$2,500 and the certificates for half units of \$1,250, the commissions paid are equal to 2.10% and 1.96% thereof, respectively.

As has been indicated, the cash surrender value at the end of the second year for full certificates is \$134. Half certificates have a surrender value of \$67. The expenses charged against the first two years' installment payments amount to \$106 for the full certificate and \$53 for the half certificate, and equal 4.24% of the maturity amounts of the certificates, and 5.89% of the total payments by certificate holders during the life of the certificates. Of the first two years' payments, actual selling commissions absorb only \$52.50 for the full certificates, and \$24.50 for the half certificates, out of total expense deductions, respectively, of \$106 and \$53, leaving "other charges" against such payments of \$53.50 and \$28.50, respectively.⁴⁷ Since most installments are paid on a monthly basis at the higher rate, as has been indicated, but the cash surrender and loan values remain the same as on an annual basis, the foregoing percentage figures for deductions will be increased in the typical case.

During the years 1929 to 1936 the aggregate installment payments by certificate holders on all certificates sold during that period amounted to \$120,550,000. Of these payments, the Corporation deducted a total of \$25,546,000⁴⁸ (21.2%), or over 21 cents of every dollar paid in by certificate holders in installments, for selling commissions or to cover other so-called procurement costs. This amount was applied by the Corporation as income and was designated on its books as "initial payment receipts." Commissions paid during this 8-year period amounted to \$16,936,000, or 14% of the total installment

⁴⁶ Op. cit. supra note 43, Item 28, and derived from supplementary information supplied the Commission.

⁴⁷ These charges are discussed in this section, supra. The \$106 and the \$53 include \$10 and \$6, respectively, of certificate reserves.

⁴⁸ Understated by an unknown amount estimated by the Corporation as some \$5,000,000. See Table, Sec. X, A, p. 49.

payments. In other words, 14 cents of every dollar paid by all certificate holders for the period went for selling commissions.⁴⁹ The percentages shown are relatively high because certificate sales were on an increasing basis. As certificates progress toward maturity the sales and other procurement costs to certificate holders' payments decline in ratio.

D. Sales Literature

The basic theme of the advertising by the Corporation to promote the sale of its certificates is compulsory "savings." Extensive use is made of pictures and emotional appeals, particularly with respect to security in old age. The Corporation in recent years has largely employed national magazines and pamphlets as its advertising media. The type of advertising utilized has borne a resemblance to that used by some life insurance companies although the primary stress has been laid at all times on accumulating for a secure old age. Emphasis is usually placed upon the need to provide a fund for the eventualities of life such as the education of children, the payment of a mortgage, or cessation of earning capacity.

The principal sales slogan of the Corporation is "Living Protection." Some typical captions of the Corporation's advertisements are as follows:⁵⁰

Your Boy Needs Living Protection.

Living Protection Gives Time to Enjoy Life.

Remember, My Boy, Always Lay By Something for the Rainy Day.

Are you a Financial Illiterate?

That is the Sort of Journey I Never Thought to Go (Over the Hill to the Poor House).

I'll Put Myself Through College.

Will You Be Independent at Her Age?

Will Enjoy the Advantages of a College Education.

All these captions and many others were used in advertisements which usually contained pictures of the security of the provident or the unhappy lot of the improvident. The purport of these advertisements is, of course, that the difference between economic security and insecurity is the ownership of certificates of Investors Syndicate or its subsidiary.

One of the Corporation's pamphlets, apparently distributed among the sales force as a prod for increased sales efforts, was a periodical called "The Broadcaster." Illustrative of the sales technique employed is the following quotation from this pamphlet:⁵¹

"If a salesman could only figure out the right thing to say at the right time there would be very little work connected with selling.

⁴⁹ The foregoing figures relating to selling commissions and initial payment receipts are based on material supplied the Commission by the Corporation. It has been assumed that these figures are gross and therefore include all payments by holders. If these figures are net, however, the percentage figures here given would increase.

⁵⁰ Reply to the Commission's questionnaire for Investors Syndicate, Item 28. See Appendix J, p. 152, for a specimen of pictorial advertising of the Corporation.

⁵¹ "The Broadcaster," Volume VIII, Number XII, December 1933. See the reply to the Commission's questionnaire for Investors Syndicate, Item 28-J, Exhibit 9.

"The following experience proved to be the 'right saying at the right time' in selling a school teacher. It came because I 'stayed a little longer.'

"I was calling on Miss Joy Jones in her school room. She told me she was carrying insurance and some sort of a savings plan and so was not interested. This, of course, meant nothing to me, and I kept on with my interview. I came to the close several times and she repeatedly said 'No.' To emphasize this 'No,' she sat in her chair yawning and registered no interest. Apparently, I was getting nowhere with her and finally decided to give up, but something seemed to tell me to go on when finally the 'right saying' came out.

" 'Miss Jones,' I said, 'you school teachers are approached by every salesman that has anything to sell, and undoubtedly you have bought things you did not want and did not need. Now, there is a very definite remedy for this. If you will obligate yourself to something worthwhile, such as this plan, you will not be in a position to be buying everything that comes along.'

"The yawning ceased, she registered interest, and proceeded to tell me of the things she had bought which she did not want. She had bought because she had the money on hand.

"By gaining her interest with that one saying, the sale was made. She gave me introduction cards to other teachers, and three more sales resulted.

"The lesson I learned from this valuable experience was this: Don't quit too soon; by sticking a little longer the 'right thing to say' may come. Had I quit, I would not have found the 'right thing to say' which made possible these four sales."

The Corporation spent an aggregate of \$1,103,128 for advertising for the years 1928 to 1936. Table 5 indicates for each of these years the amounts so spent by the Corporation and by Investors Syndicate Title & Guaranty Company since 1930, the percentage relationship to the maturity amount of the certificates sold during each of those years and the average advertising cost per certificate sold: ⁵²

TABLE 5.—Advertising expenses of Investors Syndicate and subsidiary

Year	Cost of advertising	Percent of face amount of contracts written	Average cost per contract written	Year	Cost of advertising	Percent of face amount of contracts written	Average cost per contract written
		<i>Percent</i>				<i>Percent</i>	
1928-----	\$76,306	0.10	\$2.24	1934-----	\$143,418	0.11	\$2.26
1929-----	111,448	.11	1.70	1935-----	158,247	.10	2.14
1930-----	100,395	.10	1.70	1936-----	194,458	.11	2.78
1931-----	110,905	.12	1.83				
1932-----	90,831	.09	1.44	Total..	1,103,128	.11	2.08
1933-----	117,120	.14	2.85				

⁵² Since the advertising costs have been paid by Installment Securities Agency, Inc., a subsidiary of the Corporation, these costs do not appear in the income statement (unconsolidated) which appears infra, Sec. X, p. 48.

E. Status of Outstanding Certificates

At December 31, 1936 the status of outstanding certificates was as follows: ⁵³

	Installment certificates	Single pay- ment certi- ficates	Coupon certificates	Totals
Number of certificates.....	281, 837	2, 093	7, 610	291, 539
Total maturity amount.....	\$620, 307, 867	\$1, 311, 500	\$3, 829, 700	\$625, 449, 067
Percent of total.....	99. 2%	0. 2%	0. 6%	100. 0%
Average maturity amount.....	\$2, 201	\$627	\$503	\$2, 145
Total cash surrender value and reserves, all certificates.....				\$83, 571, 438

The total installment payments required by these certificates, if they are all carried to maturity, equal about 75% of total maturity face amount of these certificates.⁵⁴ In other words the total installments paid and to be paid on outstanding certificates amount to approximately \$470,000,000, or 75% of approximately \$625,500,000. Total cash surrender value and advance payments liability as of December 31, 1936 was \$65,229,135. Other contract liabilities and reserves, namely, so-called "certificate reserve" and "contingent liability" amounted to \$18,342,303, making a grand total of contract liabilities and reserves of \$83,571,438.

Over 95% of all certificates issued and outstanding are of the installment type. This suggests that practically all the investors in the certificates of the Corporation and its subsidiary are persons of ordinary means.

F. Number of Certificates Outstanding

At December 31, 1936 there were 234,280 investors who held 291,539 certificates of Investors Syndicate and Investors Syndicate Title & Guaranty Company with a total maturity amount of \$625,449,067. Thus the theoretical average maturity amount of certificates per holder was \$2,770, or 1¼ full certificates. On a sample study covering 21,327 consecutive certificates issued by the Corporation during the year 1935, certificates in denominations or maturity amounts of \$1,250 and \$2,500 accounted for 37.1% and 47.4%, respectively, of all these certificates. In other words, 84.5% of all certificates represented in the sample study ⁵⁵ were of the \$1,250 and \$2,500 denominations.

⁵³ Derived from supplementary information supplied the Commission for Investors Syndicate—Report of Examination, Banking Division, Department of Commerce, State of Minnesota, for the year 1936.

⁵⁴ Reply to the Commission's questionnaire for Investors Syndicate, Item 22.

⁵⁵ See the reply to the Commission's questionnaire for Investors Syndicate, Table 20.

G. Changes in Types of Installment Certificates ⁵⁶

Since 1928 all installment and single payment certificates have provided for optional annuity maturity settlements—the privilege of the holder at full maturity of the certificate to take the maturity amount in installments plus interest. However, these contracts also contain a call provision whereby the Corporation could defeat any optional annuity settlement privilege at maturity by calling for the surrender of the contract for payment of its maturity value in a lump sum. In other words, these contracts, while containing provision for optional annuities, are in fact optional annuity contracts only at the Corporation's election except as to Series F, which had no call provision.

Certificates of the first three series had 10-year maturity terms, \$1,000 unit maturity amounts and had printed prominently on their face the symbols, "5½%." This would imply an interest-bearing obligation similar to a debenture or bond. However, as previously noted, these contracts are not and cannot be considered interest-bearing contracts. They are penalty and forfeiture contracts which permit of a maximum yield or return equivalent to 5½%, compounded annually, provided no default or delinquency occurs during the contract term; and provided further that payments by the contract holders are made annually in advance promptly on the due date.

Annual installments in all these three series were \$74 per \$1,000 maturity amount. The first series was designated the #50,000 series and attained a cash surrender value only at the end of two years. The second series, known as the #200,000 series, was issued between January 1928 and February 1930, and a cash surrender value was attained only 18 months after issuance of the certificate. The third series, designated as the A series and issued between February 1930 and August 1932, differed only slightly from the #200,000 series. The total annual payments, on a monthly payment basis, were \$75.60 for Series #50,000 and \$78 for Series #200,000.

Cash surrender values of the certificates in these three series were increased slightly for each year of the certificate over those in effect for the prior series. Whereas in the two previous series cash surrender values equaled the total of the amount paid in by certificate holders only at the end of the sixth year, in the A series the cash surrender value equaled the amount paid in at the end of the fifth year.

Certificates of the three remaining series, B, D, and F, had maturity terms of 15 years, instead of 10 years as in the preceding series, and as described above, the maximum possible yields to the contract holder were 5%, 4½%, and 4%, respectively, on the basis of total installments to be paid, without allowing for any deductions whatsoever. The maturity amount of the B series was \$2,600 and for both Series D and Series F was \$2,500. Annual installments were \$114, \$116, and \$120, respectively. However, most installments were paid on a monthly basis, which called for higher rates of interest payment by

⁵⁶ A tabulation of types of installment certificates written for the period from January 1, 1927 to September 17, 1937, with unit maturity amount, interest rates, period written, and annual installments, with a comparison of installments paid and cash surrender values for each type for 7 years is shown in Appendix H, p. 150.

certificate holders. These total annual payments, on a monthly basis, were \$120, \$120 and \$126, respectively. On the basis of each \$1,000 of maturity amount for all three series the annual installments were for the Series B, \$43.846; for the Series D, \$46.40; and for the Series F, \$48.00.

For the B and D series a surrender value was attained only at the end of 18 months, while for the F series the first surrender value was at the end of the first year. From the end of the second year on, little difference as to cash surrender value existed among Series B, D, and F, except that Series B, with a 5% maximum possible yield attained a cash surrender value equal to or greater than paid-up installments within five years; Series D, with a 4½% maximum possible yield within six years; and Series F, with a 4% maximum possible yield within seven years. This statement is predicated upon the payment of installments annually in advance. Payment on any other basis would delay the "break even" date by about one year in each case.

Of course, the Corporation to pay the face or maturity amount has to earn more than the above maximum possible yields on its contracts. This is attributable to the fact that a substantial portion of the payments during the first two years of the contracts is disbursed as selling commissions and other so-called procurement costs. The Corporation, therefore, does not retain all these amounts deducted and does not invest that portion of the installment payments. Stated simply, a substantial portion of the installment payments is disbursed to salesmen and for other so-called procurement costs and is therefore not available to the Corporation for investment. The Corporation, in order to improve the contract at the rate of 4% on the basis of the total payments made by investors, has to earn a higher percent on the basis of the portion of the installment payments retained by the company for investment.

Because of commissions paid and other initial expenses charged in the first two years against installment payments, the various series of certificates sold show wide variations in earnings needed to meet the interest requirements throughout the maturity terms of certificates. The gross improvement rate therefore⁵⁷ of the various certificates, varies from 5.50% to 7% for two of the series; 5.50% to 7.11% for one series; 5% to 6% for one series; and 4.50% to 5.34% for one series.

VI. SURRENDERS, LAPSES, AND MATURITIES OF CERTIFICATES

From January 1, 1927, to December 31, 1936, a total of \$31,111,000, maturity amount, of investment certificates of the Corporation matured.⁵⁸ During the same period payments to holders who surrendered their certificates prior to maturity aggregated \$29,005,000,⁵⁹ based entirely or practically so on cash surrender values. The Corporation therefore paid out to certificate holders during this period, either at maturity or upon surrender before maturity an aggregate of approximately \$60,116,000.

⁵⁷ For a discussion of the Corporation's ability to meet these earnings requirements see *infra*, Sec. X, p. 48.

⁵⁸ As reported by the Corporation to the Commission. (Reply to the Commission's questionnaire for Investors Syndicate, Item 35.)

⁵⁹ *Ibid*.

Table 6 shows the payments to certificate holders by years from 1927 to 1936, inclusive:

TABLE 6.—*Payments to certificate holders of Investors Syndicate, 1927–1936*

[Amounts in thousands of dollars]

Year	Payments to—			Year	Payments to—		
	Holders of matured certificates ^a	Holders of other than matured certificates ^b	Holders of all certificates ^b		Holders of matured certificates ^a	Holders of other than matured certificates ^b	Holders of all certificates ^b
1927.....	1, 286	2, 237	3, 523	1933.....	3, 291	4, 462	8, 383
1928.....	751	2, 198	2, 949	1934.....	4, 034	3, 831	7, 865
1929.....	1, 336	305	1, 641	1935.....	4, 204	^c 4, 786	8, 990
1930.....	3, 251	1, 263	4, 514	1936.....	5, 059	^c 2, 944	8, 003
1931.....	3, 675	2, 593	6, 268	Total...	31, 111	29, 005	60, 116
1932.....	3, 595	4, 386	7, 981				

^a As returned for matured certificates (see the reply to the Commission's questionnaire for Investors Syndicate, table 21). No deduction for option settlements, which total \$898,927.

^b As constructed; see Appendix C, p. 144.

^c Includes \$2,338,275 for 1935 and \$15,369 for 1936, for called certificates.

Figures for various periods are not available for total annual payments to all certificate holders and the number and amount of certificates affected by lapsation, surrender, and maturity.⁶⁰

The number and maturity amount of certificates outstanding and in force at December 31, 1936, were as follows:

Number of certificates outstanding.....	291, 539
Maturity amount of certificates outstanding.....	\$625, 449, 067

These totals subtracted from the grand total of 601,383 "contracts written" or "certificates issued"⁶¹ with an aggregate maturity value or face amount of \$1,100,707,050 indicates that 309,844 certificates with a total maturity amount of \$475,257,983 either lapsed, were surrendered before maturity, or matured during the 10-year period. Since 22,816 certificates, representing \$31,110,857 in maturity amount, matured during this period, 287,028 certificates, with an aggregate face amount of \$444,147,126, either lapsed or were surrendered before maturity during the period. Lapsed certificates are subject to reinstatement.

⁶⁰ As constructed; see Appendix C, p. 144.

⁶¹ This is the total of the number of certificates issued from 1927 through 1936 plus the number of certificates in force at January 1, 1927.

During the years 1927 to 1936 sales of certificates, with maturity terms of 10 or 15 years, were on a constantly increasing basis. Therefore, the percentage of certificates which matured in relation to total exits (maturities, lapses, surrenders before maturity) would be lower than otherwise and the percentage which lapsed (terminations within the first year when the certificates have no surrender value) and were surrendered (terminations at any time after the end of the first year when the certificates have a surrender value and before maturity) would be higher. Subject to this qualification, it may be seen that during this 1927-36 period, the ratio of certificates which went to maturity to the certificates which were lapsed and surrendered is thus 1 to 12½ with respect to the number of certificates and 1 to 14⅔ with respect to the face amount of the certificates. Otherwise stated, 12½ certificates lapsed or were surrendered prior to maturity for every certificate which reached maturity, and \$14.28 face amount of certificates lapsed or was surrendered prior to maturity for every \$1 face amount of certificates which reached maturity. However, under a balanced state of attained condition toward maturity and sales the ratios of maturities would rise and lapses and surrenders would decline.

Holders of certificates which matured in the period from January 1, 1927, to December 31, 1936, received \$31,110,857 from the Corporation. These holders had paid to the Corporation a total of \$23,096,121. They therefore gained \$8,014,736 on their investment. No exact data were available with respect to the experience of the holders of certificates which lapsed and/or were surrendered before maturity.⁶²

VII. PURCHASERS OF CERTIFICATES

A. Number of Certificate Holders and Certificates in Force

The persons to whom the certificates of the Corporation are sold represent practically all types of occupations and activities.

The number of certificate holders, the number of certificates in force (including single payment and coupon certificates), the maturity amounts of these certificates and the total contract liabilities and reserves applicable thereto, at December 31 for the years 1926 to 1936, are given in Table 7.⁶³

⁶² See *infra*, Sec. XI, *The Experience of Investors*, p. 54.

⁶³ See Sec. XI, *Experience of Investors*.

TABLE 7.—*Number of certificate holders and maturity amounts, and cash surrender values for certificates in force, annually, 1926–1936*

Year	Number of certificate holders	Number of certificates in force	Maturity amount		Cash sur- render val- ue, etc.	Cash sur- render val- ue as per- cent of maturity amount
			Total	Average		
			000 omitted		000 omitted	
1926.....	59,662	73,657	\$106,437	\$1,445	\$15,193	14.3
1927.....	71,158	86,849	125,445	1,444	17,962	14.3
1928.....	106,895	125,759	183,347	1,458	23,250	12.7
1929.....	144,075	171,518	263,146	1,534	29,799	11.3
1930.....	160,427	193,285	309,847	1,603	36,800	11.9
1931.....	171,657	209,338	324,283	1,549	44,063	13.6
1932.....	171,183	216,077	333,220	1,542	47,701	14.3
1933.....	170,192	210,113	346,010	1,647	50,725	14.7
1934.....	181,872	224,533	403,464	1,797	57,634	14.3
1935.....	208,698	254,510	503,855	1,980	67,712	13.4
1936.....	234,280	291,539	625,449	2,145	83,572	13.4

The average number of certificates held by each certificate holder approximates for the entire 10-year period 1¼ certificates, while the average maturity amount of outstanding certificates varied from a low of \$1,444 in 1927 to a high of \$2,145 in 1936. Except for a decline in the years 1931 and 1932 the average amount of outstanding certificates has been on a constant upward trend.

The New York subsidiary of the Corporation, Investors Syndicate Title & Guaranty Company, had certificate holders and certificates outstanding, from 1930 to 1936, as follows: ⁶⁴

Year	Number of certificate holders	Number of certificates in force	Maturity amount of certificates in force (000 omitted)	Year	Number of certificate holders	Number of certificates in force	Maturity amount of certificates in force (000 omitted)
1930.....	2,395	2,495	5,259	1934.....	14,080	15,304	37,020
1931.....	7,201	7,580	15,677	1935.....	14,775	16,417	40,151
1932.....	12,656	13,464	31,203	1936.....	15,954	18,130	44,990
1933.....	13,537	14,556	34,910				

B. Geographical Distribution of Certificate Holders ⁶⁵

It appears that more certificates were sold, in relation to the population, in the Western States than the Eastern and Central States, as Table 8, based on the maturity amount of certificates in force, indicates: ⁶⁶

⁶⁴ Reply to the Commission's questionnaire for Investors Syndicate Title & Guaranty Company, Item 35.

⁶⁵ A detailed tabulation of the geographical distribution of certificates in force at December 31, 1936, according to maturity amount and reserve liability in each state and the estimated population of each of 45 states and the District of Columbia at July 1, 1935, with percentages shown for each classification, will be found in Appendix I, p. 151. (Reply to the Commission's questionnaire for Investors Syndicate, Item 32.)

⁶⁶ Ibid. These differences may be attributable to the fact that the certificates have been sold for a longer period of time in some states than in others.

TABLE 8.—*Geographical distribution of certificates sold by Investors Syndicate (in maturity amounts)*

Western States			Eastern States		
State	Percent of maturity amount in force	Percent of "total" population	State	Percent of maturity amount	Percent of "total" population
California.....	6.43	4.46	Connecticut.....	4.28	1.36
Colorado.....	2.60	.84	Illinois.....	1.55	6.18
Kansas.....	6.59	1.46	Indiana.....	1.23	2.71
Michigan.....	5.09	3.68	Massachusetts.....	3.45	3.44
Minnesota.....	11.90	2.08	New Jersey.....	1.83	3.39
Montana.....	2.18	.42	New York.....	4.00	10.20
Nebraska.....	.17	1.08	Pennsylvania.....	1.70	7.96
North Dakota.....	2.49	.55	Wisconsin.....	.31	2.30
South Dakota.....	2.89	.53			
Washington.....	1.10	1.29			
Total.....	41.44	16.39	Total.....	18.35	37.54

The Southern States, as a group, appear to show a close percentage relationship between the maturity amount of certificates in force and the population as the following table shows: ⁶⁷

State	Percent of maturity amount	Percent of population	State	Percent of maturity amount	Percent of population
Alabama.....	3.32	2.24	Maryland.....	0.99	1.32
Arkansas.....	.54	1.53	Mississippi.....	2.59	1.55
Florida.....	1.55	1.28	North Carolina.....	1.73	2.70
Georgia.....	1.61	2.64			
Kentucky.....	1.42	2.25	Total.....	14.24	17.24
Louisiana.....	.49	1.68			

Reference to Appendix I will disclose a close and consistent relationship between the maturity amount of certificates in force and the reserve liabilities set up against them.

C. Occupations of Certificate Holders

A study of the occupations of certificate holders was completed by the Corporation in 1935 covering 21,342 consecutive certificates. This study showed that over 103 classified occupations, callings, or activities were represented among the certificate holders. The 10 largest occupational groups arranged in order of their rank in the survey were: teachers, 2,140; housewives, 1,213; clerks, 1,149; salesmen, 1,125; managers, 1,040; merchants, 923; physicians, 687; stenographers, 683; nurses, 577; service-station operators, etc., 564; bookkeepers, 494; and hotel and restaurant workers, etc., 447. A list of the groups represented in the study, with the number represented by each group, is given in Table 9.⁶⁸

⁶⁷ Reply to the Commission's questionnaire for Investors Syndicate, Item 32.

⁶⁸ Id., Item 33.

TABLE 9.—Occupations of certificate holders of Investors Syndicate

Occupation	Num-ber of certi-fi-cate holders	Occupation	Num-ber of certi-fi-cate holders	Occupation	Num-ber of certi-fi-cate holders
Accountant.....	38	Executive.....	126	Physician.....	687
Advertising.....	40	Express.....	2	Plumber.....	48
Architect.....	56	Factory.....	241	Police.....	75
Artist.....	32	Farmer.....	420	Postal Service.....	205
Athlete.....	20	Fire department.....	37	Printer.....	119
Auditor.....	11	Florist.....	3	Proprietor.....	309
Auto business.....	130	Foreman.....	259	Public office.....	168
Aviation.....	35	Foresters and rangers.....	12	Radio.....	48
Baker.....	69	Geologist.....	4	Railroad.....	252
Banker.....	49	Grocer.....	269	Rancher.....	10
Barber.....	124	Hotels and restaurant.....	447	Real estate.....	39
Beautician.....	244	Household employees.....	142	Retired.....	23
Bookkeeper.....	494	Housewife.....	1, 213	Salesman.....	1, 125
Broker.....	5	Insurance.....	137	Sales representative and manager.....	18
Building trades.....	96	Janitor.....	33	Secretary.....	60
Butcher.....	102	Jeweler.....	47	Service station.....	564
Buyer.....	28	Laborer.....	340	Social worker.....	2
Cashier.....	114	Laundry.....	77	Shoemaker.....	29
Chauffeur and truck driver.....	192	Lawyer.....	217	Stenographer.....	683
Chemist.....	91	Librarian.....	42	Stockman.....	9
Chiropractor.....	26	Lumber and forestry.....	148	Student.....	21
City official.....	26	Machinist.....	410	Supervisor.....	40
Clergyman.....	172	Manager.....	1, 040	Tailor.....	51
Clerical.....	1, 149	Manufacturer.....	111	Teacher.....	2, 140
Commissioner.....	6	Merchant.....	923	Telephone and tele-graph.....	174
Contractor.....	69	Miller.....	12	Theater.....	67
Creamery.....	123	Milliner.....	10	Trucking.....	20
Dairyman.....	14	Military and navy.....	261	Undertaker.....	63
Dentist.....	282	Miner.....	134	Veterinarian.....	24
Dietician.....	3	Musician.....	29	Welder.....	1
Driller.....	4	Newspaper.....	99	Miscellaneous.....	1, 645
Druggist.....	209	Nurse.....	577		
Electrician.....	111	Oil and gas.....	221		
Elevator operator.....	8	Optometrist.....	6		
Engineer.....	363	Osteopath.....	5		
Estimator.....	1	Pharmacist.....	5		
		Photographer.....	28	Total.....	21, 342

D. Economic Position of Certificate Holders

No direct data are available to indicate the exact economic status of the holders of the certificates of the Corporation. Since 95% of the certificates outstanding are of the installment type, however, and the sample study described in the preceding section indicates that the great majority of holders were engaged in occupations in the comparatively low earnings brackets, it appears highly probable that the certificates are sold, in the main, to persons of ordinary means.

VIII. CONTRACT LIABILITIES AND RESERVES

The contract liabilities of the Corporation are reflected in four accounts: (1) "Cash Surrender Value Liability," (2) "Advance Payments Liability," (3) "Contingent Liability," (4) "Certificate Re-

serve.” None of these accounts involves the actual deposit or earmarking of specific funds.⁶⁹

(1) The “Cash Surrender Value Liability” is set up on the books of the Corporation as of completed anniversaries. It represents the amount which holders of outstanding certificates may borrow against their certificates, or receive upon surrender thereof to the Corporation as specified by the contract. It thus represents the total amount for which the Corporation may be liable on account of surrenders or terminations by certificate holders at any given time.

(2) “Advance Payments Liability” represents payments by contract holders in excess of the current contract year’s requirements. These sums are in the nature of demand liabilities and bear interest at stipulated contract rates, ranging from $5\frac{1}{2}\%$ to $21\frac{1}{2}\%$. A maximum limit is imposed on advance payments in any one contract year. Payments on account of the contracts are credited out of the “advance payments liability” account as such payments become due.

(3) The so-called “Contingent Liability” account represents an accumulation of interim installment payments between anniversary dates and contains completed annual installments on certificates which are merely awaiting arrival of anniversary dates before being transferred to the “cash surrender value liability” account.⁷⁰ With respect to the early certificates issued, if the holder made all the monthly payments during the first year and then surrendered his certificate, he did not receive any portion of the sums paid, since the certificate according to these terms had no surrender value at that time. If the holder made all the 12 additional monthly payments during the second year and surrendered his certificate at the end of the second year, he received a surrender value of the certificate, which on the basis of annual payments in advance was about 47% of the total amount he paid. If his payments were on a monthly basis, which most payments were, the surrender value was two or three percent lower than 47% of the total amount paid. However, if during the second year he made 11 monthly payments and then surrendered his certificate, he would not receive any surrender value, since he did not make the required payments to the anniversary date, that is, 24 payments. In other words, to attain a surrender value for the payments made during a contract year, all the payments for that contract year have to be made and the time paid for, exclusive of all periods of default, has to elapse. If the holder defaults in only one payment, no surrender value is attained on account of all the other payments he made during that year. The contract holder, after a lapse, can obtain the benefit of his payments already made on the contract only by the payment of additional sums on a reinstatement of his contract.

Upon completion of the anniversaries, the appropriate amount of the “contingent liability” account is transferred to the “cash surrender value liability” account. In other words, when a full year’s payments are received, and the required time has elapsed, the amounts are charged out of the “contingent liability” account to the credit of the “cash surrender value” account. From time to time as certificates

⁶⁹ Id., Item 50.

⁷⁰ The term “contingent liability” as used by Investors Syndicate relates to liabilities in nature proximately actual and only negligibly and remotely contingent.

are affected by lapse or surrender between anniversary dates, interim installment payment credits in the account revert to the Corporation and are treated as income by the Corporation. Whenever necessary, additional sums out of income or certificate reserve are also transferred to the "cash surrender value liability" account.

(4) The "Certificate Reserve" account represents the reserve set up on the books of the Corporation both out of initial payment receipts from certificate holders and, later, from general income. This account is maintained until lapses or surrenders cause the transfer of credits in this "Certificate Reserve" account to the income account of the Corporation, or the occurrence of multiple anniversaries⁷¹ causes the transfer of applicable credits into the "cash surrender value" account. For the series "F" certificates, in the sixth, tenth, and twelfth years a part of the stated reserve is transferred to the "cash surrender value" account and in the fifteenth year all the then stated reserve remaining in the account is transferred to the "cash surrender value" account so as to equal the maturity amount of the contract. The certificate reserve may be considered an additional reserve to provide for the maturity of the contract. Table 10 indicates the status of the contract liabilities and reserves as of December 31 of each year shown.⁷²

TABLE 10.—*Contract reserves of Investors Syndicate at year-ends, 1926–36*

[Amounts in thousands of dollars]

Year	Total	Cash sur- render value ^a	Certificate contingent liability	Certificate reserve
1926.....	15,193	10,725	3,280	1,188
1927.....	17,962	13,337	3,035	1,590
1928.....	23,250	17,552	3,661	2,037
1929.....	29,799	22,654	4,380	2,765
1930.....	36,800	27,510	5,478	3,812
1931.....	44,063	32,983	6,389	4,691
1932.....	47,700	36,078	6,829	4,793
1933.....	50,725	38,943	7,010	4,772
1934.....	57,633	44,412	7,645	5,576
1935.....	67,712	52,143	9,109	6,460
1936.....	83,571	65,229	11,661	6,681

^a Figures in this column include liability of the Corporation for advance payments, which are demand liabilities.

It will be observed from this table that for the period from December 31, 1926, to December 31, 1936, total contract liabilities and reserves have expanded each year, from a total of \$15,193,000 at the beginning of the period to a total of \$83,571,000 at the end of the period, thus reflecting the net increase in the number of certificates and in the Corporation's liability on certificates outstanding. The year of the smallest increase was 1933 with an increase of \$3,025,000, while the largest increase in any year during the period, \$15,859,000, was in 1936.

The cash surrender value account showed increases for each year during the period. The smallest relative increase was \$2,865,000 in

⁷¹ For the Corporation's statement as to its practice of surrenders between anniversary dates, see *infra*.

⁷² Reply to the Commission's questionnaire for Investors Syndicate, Item 50.

1933 and the largest increase, both actual and relative, was \$13,086,000 in 1936. The certificate contingent liability account showed a slight decrease, \$245,000, in 1927. The smallest increase, \$181,000, was in 1933, and the largest increase, \$2,552,000, was in 1936. These two accounts moved coordinately during the period. The certificate reserve account increased throughout the period except for the year 1933, in which there was a decline of \$21,000. The year 1932 showed a small increase, \$102,000, while the increase for 1936, \$201,000, was small, both actually and relatively.⁷³

With respect to the type of installment certificates of \$2,500 maturity amount which was issued at the end of 1936 (Series F), the "certificate reserve" liability account differed from this account in previous years in the amount or rate of credits to the account. At the end of 1936 and thereafter this account carried credits for all certificates in force and according to installment payments actually made, at each year-end or certificate anniversary. These credits, according to the number of years of payment, are: 1st, \$5.00; 2nd, \$10.00; 3rd \$10.00; 4th \$16.00; 5th, \$24.00; 6th, \$20.00; 7th, \$26.00; 8th, \$36.00; 9th, \$44.00; 10th, \$16.00; 11th, \$32.00; 12th, \$30.00; 13th, \$34.00; 14th, \$34.00; and 15th, \$0.00.⁷⁴

If certificates are surrendered before maturity, the credits in the "certificate reserve" applicable to such certificates are released to the Corporation and become, in effect, income credits of the Corporation. The account might give the impression that reserves exist in which certificate holders have vested rights, which is not a fact.⁷⁵

IX. MANAGEMENT OF ASSETS

A. Investment Policy

Until the year 1932 the investments of Investors Syndicate consisted almost entirely of real estate mortgages.⁷⁶ In that year, this investment policy was changed, and the Corporation began to invest its funds in bonds and preferred stocks.⁷⁷ In 1935 about 40% of the assets of the Corporation was represented by stocks and bonds.⁷⁸ While the major factor in this change of policy was the increasingly unfavorable condition of the real estate market, a very important contributing factor was the advisability for a more liquid and dependable portfolio.

At the end of 1932 the total assets of the Corporation were \$50,473,000,⁷⁹ with stocks and bonds of the value, at market, of \$5,127,000, and first mortgages in the principal amount of \$31,974,000, or a ratio of securities to mortgages of about 1 to 6. By the end of 1934, the total assets of the Corporation were \$59,737,000,⁸⁰ with

⁷³ See Sec. X, C, pp. 50-51.

⁷⁴ In the 6th, 10th, and 12th years a part of the certificate reserve (and for the 15th year, all of the certificate reserve) has been credited to cash surrender values.

⁷⁵ Public Examination, Investors Syndicate, at 21581.

⁷⁶ Reply to the Commission's questionnaire for Investors Syndicate, Items 36, 37, 38, and 50.

⁷⁷ Ibid.

⁷⁸ Ibid.

⁷⁹ Ibid. The remaining assets consisted of certificate loans, real estate, cash, etc.

⁸⁰ Ibid.

investments in stocks and bonds of \$24,002,000 at market, and investments in mortgages of \$22,257,000, or a ratio of about 1 to 1. This trend of increase in the proportion of investments in stocks and bonds continued to 1935, but in 1936 the trend shifted and first mortgages again predominated in the assets of the Corporation.

At the end of that year, the gross assets of the Corporation were \$87,092,000.⁸¹ Bonds and stocks amounted to \$25,742,000, and first mortgages amounted to \$48,920,000, including mortgages guaranteed by the Federal Housing Administrator in the amount of \$14,826,000.⁸²

Holdings in real estate and in contracts for the sale of real estate began to assume important proportions in the portfolio of the Corporation in 1931. At the end of that year these holdings totaled \$3,676,000, and increased to a total of \$6,513,000 in 1932.⁸³

This type of investment declined in 1933, largely as a result of the transfer of property to a wholly-owned subsidiary, Southwestern Mortgage Loan Corporation, created especially in connection with a loan of \$4,000,000 which the Corporation obtained from the Reconstruction Finance Corporation.⁸⁴ Thereafter the interest of the Corporation in this real property transferred to this subsidiary was reflected as "investments in the stock of subsidiaries," which then rose from \$358,000 in 1932 to \$4,067,000 in 1933.⁸⁵ Through defaults and foreclosures in its mortgage investments, the Corporation's investments in real estate and in contracts for the sale of real estate rose to a total of \$7,488,000 by the end of 1935. Investments in real estate and contracts for the sale of real estate were reduced to \$5,277,000 by the end of 1936 largely through individual sales of these properties for relatively small down payments and relatively large purchase money mortgages on these properties. The investments in real estate of the Corporation, including subsidiaries on a consolidated basis, were \$12,728,000 in 1935 and \$9,776,000 in 1936.⁸⁶

B. Loans to Holders of Certificates

Loans by the Corporation to holders of certificates began to rise to substantial amounts in 1929, when the total of such loans outstanding at the end of the year was \$1,530,000. This item increased steadily to the end of 1933 when the total amount shown was \$4,089,000. These loans declined during 1934 and 1935 with totals of \$3,408,000 and \$3,374,000 for these respective year-ends, but increased to \$3,931,000 by the end of 1936.⁸⁷

C. Cash Position of the Corporation

The cash position of the Corporation increased from \$2,513,000 in 1932 to \$5,970,000 in 1933, reflecting in large part the loan to the Corporation from the Reconstruction Finance Corporation. The amount of cash declined in 1934 to \$3,747,000, remained about the same in 1935 and declined further in 1936 to \$2,419,000.⁸⁸

⁸¹ *Ibid.*

⁸² *Ibid.*

⁸³ *Ibid.*

⁸⁴ *Ibid.*

⁸⁵ *Ibid.*

⁸⁶ *Ibid* and see *infra*, Sec. I, p. 41, and note 103, p. 43.

⁸⁷ *Op. cit. supra*, note 78.

⁸⁸ *Ibid.*

D. Composition of the Corporation's Assets

Table 11 shows the principal items of the Corporation's assets for each year-end from 1927 to 1936:⁸⁹

TABLE 11.—*Classification of assets of Investors Syndicate at year-ends, 1927-36*

[Amounts in thousands of dollars]

Year	Cash	Bonds and stocks ^a	First mortgages ^b	Certificate loans	Real estate	Miscellaneous	Total
1927.....	561	1, 130	16, 203	805	382	98	19, 179
1928.....	417	699	22, 092	1, 019	474	216	24, 917
1929.....	483	1, 248	27, 875	1, 530	665	404	32, 205
1930.....	457	2, 438	32, 399	2, 180	873	463	38, 810
1931.....	713	4, 157	35, 532	3, 094	2, 454	696	46, 646
1932.....	2, 513	5, 127	33, 581	4, 029	4, 906	317	50, 473
1933.....	5, 970	11, 615	30, 110	4, 089	2, 269	462	54, 515
1934.....	3, 747	24, 002	23, 372	3, 408	4, 784	424	59, 737
1935.....	3, 870	28, 674	26, 866	3, 374	6, 616	590	69, 990
1936.....	2, 419	25, 742	48, 920	3, 931	5, 277	803	87, 092

PERCENTAGES

1927.....	2.9	5.9	84.5	4.2	2.9	0.5	100.0
1928.....	1.6	2.8	88.7	4.1	1.9	.9	100.0
1929.....	1.5	3.9	86.5	4.7	2.1	1.3	100.0
1930.....	1.2	6.3	83.5	5.6	2.2	1.2	100.0
1931.....	1.5	8.9	76.2	6.6	5.3	1.5	100.0
1932.....	5.0	10.2	66.5	8.0	9.7	.6	100.0
1933.....	11.0	21.3	55.2	7.5	4.2	.8	100.0
1934.....	6.3	40.2	39.1	5.7	8.0	.7	100.0
1935.....	5.5	41.0	38.4	4.8	9.5	.8	100.0
1936.....	2.8	29.6	56.2	4.5	6.0	.9	100.0

^a The Corporation's holdings of stocks, except for the capital stock of subsidiaries, were relatively unimportant. Investments in capital stocks of subsidiaries were as follows: 1927, \$25,000; 1928, \$37,000; 1929, \$10; 1930, \$183,000; 1931, \$358,000; 1932, \$358,000; 1933, \$4,067,000; 1934, \$3,723,000; 1935, \$3,753,000; 1936, \$3,616,000. With the payment of the loan due the Reconstruction Finance Corporation in 1937 the subsidiaries to which the loan was made were dissolved and investments in subsidiaries were reduced to \$611,000.

^b Includes amortizing contracts of sale taken in lieu of mortgages in certain States, as follows: 1927, \$746,000; 1928, \$546,000; 1929, \$802,000; 1930, \$978,000; 1931, \$1,222,000; 1932, \$1,607,000; 1933, \$1,527,000; 1934, \$1,115,000; 1935, \$873,000; and 1936, \$1,752,000.

^c Includes investments in mortgages amounting to \$14,826,000 guaranteed by the Federal Housing Administration.

Except for a profit of \$747,000 realized by the Corporation in 1936, actual realized gains or losses on investments have not been large at any time during the period 1927-1936 and are not of material importance in considering the investment policy of the Corporation. It is interesting to note in this connection that the net profit of the Corporation, after payment of taxes, amounted to \$718,000 in 1936.

E. Changes in Investment Policy

The investment policy of the Corporation was definitely changed when the present management group took control in 1925. This change had as its object an increase in the proportion of liquid assets

⁸⁹ Ibid.

of the Corporation and entailed a relative reduction of the mortgage investments and a relative increase of government, municipal, and corporation securities. The most important factors which contributed to this change in policy were the unsatisfactory conditions in the real estate market, a desire for greater diversification, and the increasing amount of borrowing from the Corporation by certificate holders against their certificates, which became particularly heavy after the onset of the depression.

The shift by the Corporation into a more liquid condition proceeded despite the facts (1) that there was a smaller average return on security investments than from real estate mortgages, and (2) that the Corporation needed relatively high-yield investments in order to realize enough profits, net after expense deduction, to service its certificate obligations, and to secure a profit on its operations.

In the year 1927 the total investments of the Corporation in relation to the total contract liabilities and reserves of the certificates were represented by 92.3% of first mortgages (including contracts of sale) and real estate, and 9.3% of stocks and bonds; and in 1928, 97.1% of mortgages and real estate and 4.6% of stocks and bonds. As the percentage of investments in mortgages and real estate declined over the ensuing years the percentages in bonds and stocks rose until 1935 when investments in mortgages and real estate represented 49% of the total contract liabilities and reserves of certificates outstanding and the investments in stocks and bonds represented 42.5%. The trend shifted in 1936, however, as shown by year-end figures which indicated on the same basis a total investment of 64.9% in mortgages and real estate and of 29.4% in bonds and stocks. The following table shows these changes by years for the period: ⁹⁰

Year	Percentage of investments to contract liabilities and reserves ^a of contracts represented by—			
	First mortgages and real estate	Bonds and other securities (including cash)	Contract liabilities and reserves	Contract liabilities and reserves, as percent of total net assets available therefor
	Percent	Percent	000 omitted	
1927.....	92.3	9.3	\$17,962	95.0
1928.....	97.1	4.6	23,250	95.7
1929.....	95.8	5.8	29,799	94.3
1930.....	90.4	7.4	36,800	98.8
1931.....	86.2	10.2	44,063	96.7
1932.....	80.7	15.3	47,700	97.1
1933.....	63.8	26.6	50,725	96.8
1934.....	48.9	41.7	57,633	97.7
1935.....	49.4	42.5	67,712	97.7
1936.....	^b 64.9	29.4	83,571	97.5

^a It will be observed that the two types of investments total more than 100% in some years. It must be borne in mind that the percentage relationship is not to total assets, including loans on certificates, investments in subsidiaries, etc., but to contract liabilities and reserves represented by outstanding certificates.

^b Of this total, 17.7% represents mortgages guaranteed by the Federal Housing Administrator in the total amount of \$14,826,000.

⁹⁰ Reply to the Commission's questionnaire for Investors Syndicate, Item 50.

F. Loan from the Reconstruction Finance Corporation

On July 9, 1933 the Corporation caused its wholly-owned subsidiary, Southern Mortgage Loan Company, to borrow \$4,000,000 from the Reconstruction Finance Corporation.⁹¹ The loan was apparently needed because, despite its efforts to replace part of its real estate and mortgage holdings with liquid securities, the Corporation had not been able to get into a sufficiently liquid condition. Concerning this loan, the Corporation stated: ⁹²

"The above loan was made in the latter part of 1933. The Company was financially sound and had ample cash and other liquid resources to meet the demands of the depression but made the loan to aid in the administration and conservation of its real estate holdings in a manner consistent with sound business judgment. The economic situation at that time was such that it was not sound policy to attempt to hastily dispose of real estate."

The mechanics of effecting this loan were simple. Two corporations, Southern Mortgage Loan Company and Southwestern Mortgage Investment Corporation, were organized by Investors Syndicate under the laws of Delaware in July 1933. The capital stock of Southern Mortgage Loan Corporation was issued to the Southwestern Mortgage Investment Corporation, whose capital stock in turn was issued to Investors Syndicate in consideration of the transfer to Southwestern Mortgage Loan Corporation by Investors Syndicate of real estate of the appraised value of about \$6,700,000. The Southwestern Mortgage Investment Company thereupon mortgaged this real estate to its subsidiary, Southern Mortgage Loan Corporation, which in turn assigned the mortgage to the Reconstruction Finance Corporation to secure the loan of \$4,000,000 to the Southern Mortgage Loan Corporation. This sum was thus made available to the parent, Investors Syndicate, to improve its liquid position. This loan was repaid in 1937 and the two subsidiaries, Southern Mortgage Loan Corporation and Southwestern Mortgage Investment Company, were dissolved.⁹³

The largest cash position of Investors Syndicate at any year-end during the period 1927-1936, both actually and relatively, was in 1933, when this item amounted to \$5,970,000,⁹⁴ and was due, of course, largely to the loan from the Reconstruction Finance Corporation.

According to its year-end statements, the Corporation borrowed from banks only once—\$550,000 in 1929.⁹⁵

G. Method of Making Investments in Real Estate Mortgages

The real estate which secures the obligations (mortgages, etc.) in which the Corporation invests has always consisted principally of improved urban property, both business and residence property. Since this type of investment has always constituted such a large proportion of its investments, the Corporation has set up its own machinery to conduct its mortgage-loan operations. At December 31, 1935, the Corporation had 18 branch offices in the United States. Each

⁹¹ *Id.*, Table 38.

⁹² *Ibid.*

⁹³ Reply to Commission's questionnaire for Investors Syndicate, Supplemental Information.

⁹⁴ Reply to the Commission's questionnaire for Investors Syndicate, Item 50.

⁹⁵ *Ibid.*

of these offices had a manager and assistants, as needed, whose duties included the appraisal of property upon which loans were sought, operating properties acquired through foreclosure or otherwise upon default, and the like. These employees are hired on a salary basis. Up to 1936 the Corporation employed no independent brokers in making mortgage loans. Since 1936 brokers have been employed in connection with the mortgages guaranteed by the Federal Housing Administrator.

H. Distribution by States of Investments in Real Estate Mortgages

Table 12 shows the distribution, according to states, of investments in first mortgages⁹⁶ by the Corporation (excluding subsidiaries) at December 31, 1936, in amounts of \$50,000 or over and percentages.⁹⁷

TABLE 12.—*Geographical distribution of investments in first mortgages by Investors Syndicate of \$50,000 or more at December 31, 1936*

State ^a	Number of first mortgages	Amount (000 omitted)	Percent of total
Alabama (Birmingham, Mobile, Montgomery)	506	\$1,015	3.2
Arkansas (Little Rock)	59	110	.3
Alberta (Calgary)	21	55	.2
British Columbia (Vancouver)	405	1,058	3.3
California (Los Angeles and Oakland)	1,708	8,506	26.5
Colorado (Denver)	3	53	.2
Connecticut	14	248	.8
Florida (Tampa and Miami Beach)	60	444	1.4
Georgia (Atlanta)	896	2,266	7.1
Illinois (Chicago)	97	1,171	3.7
Indiana (Indianapolis)	30	144	.3
Michigan (Detroit, Flint, and Pontiac)	499	1,634	5.1
Minnesota (Minneapolis, St. Paul, and Duluth)	219	1,457	4.6
Missouri (Kansas City, St. Louis, Joplin, and Springfield)	116	830	2.6
New Jersey	41	292	.9
New York (New York, Albany, and Buffalo)	311	5,047	15.8
Ohio	4	136	.4
Oklahoma (Oklahoma City and Tulsa)	341	1,189	3.7
Oregon (Portland)	362	845	2.6
Pennsylvania (Philadelphia and Pittsburgh)	25	773	2.4
Texas (Dallas, Fort Worth, Houston, and San Antonio)	1,262	3,996	12.3
Utah (Salt Lake City)	59	122	.4
Washington (Seattle)	185	365	1.1
Wyoming (Cheyenne)	91	159	.5
Miscellaneous	36	72	.2
Total	7,350	\$31,987	100.0

^a Cities in parentheses after a State represent the only cities in that State in which investments in mortgages were held.

⁹⁶ Other than mortgages guaranteed by the Federal Housing Administrator.

⁹⁷ Derived from supplementary information supplied the Commission for Investors Syndicate. (Report of Examination, Department of Commerce, Division of Banking, State of Minnesota, 1936, p. 7.)

Approximately 80% of the total of the above investments relate to property located in nine States and approximately 48% in three cities:⁹⁸

	<i>Percent</i>		<i>Percent</i>
Alabama-----	3.2	New York-----	15.8
California-----	26.5	(New York City, 15.0%.)	
(Los Angeles, 24.7%.)		Oklahoma-----	3.7
Georgia (only Atlanta)-----	7.1	Texas (Houston, 8.1%)-----	12.5
Illinois (only Chicago)-----	3.7		
Michigan-----	5.1	Total-----	82.2
Minnesota (only \$2,000 in Duluth—			
balance in Twin Cities)-----	4.6		

The percentages for Los Angeles (24.7%), New York (15%), and Houston (8.1%) seem high, both actually and relatively.

I. Status of Investments in Real Estate and Real Estate Mortgages

The balance due to Investors Syndicate on first mortgages on real estate was \$32,100,358 at December 31, 1936, not including \$14,769,953 of such mortgages guaranteed by the Federal Housing Administrator. The amount of such balance shown on the balance sheet of the Corporation as of that date was \$31,987,508, after reserves of \$112,850. The amount of \$32,100,358 for December 31, 1936, and the amount of \$25,685,670 for the year ending December 31, 1935, were classified in the reports on examination by the Department of Commerce, Banking Division, State of Minnesota, as follows:⁹⁹

	1935		1936	
	Amount	Percent	Amount	Percent
Current-----	\$18,764,054	73.0	\$28,174,335	87.8
2 to 5 payments delinquent-----	1,435,950	5.6	1,793,697	5.6
6 or more payments delinquent-----	4,465,464	17.4	1,450,337	4.5
Foreclosures-----	1,020,202	4.0	681,989	2.1
Total-----	\$25,685,670	100.0	\$32,100,358	100.0

Table 13 indicates the location of mortgaged property, covered by mortgages of \$50,000 or more in delinquent status or the subject of foreclosure proceedings, and the amounts due under the mortgages thereon at December 31, 1935.¹⁰⁰

⁹⁸ Ibid.

⁹⁹ Reply to the Commission's questionnaire for Investors Syndicate, Item 17 and derived from supplementary information supplied the Commission (Report for the years 1935 and 1936).

¹⁰⁰ Ibid.

TABLE 13.—*Location and status of mortgaged property with mortgages of \$50,000 or more held by Investors Syndicate at December 31, 1935*

Location	2 to 5 payments delinquent	6 or more payments delinquent	Fore-closures	Total	Total as percent of all mortgages for cities shown
Birmingham, Ala.....	\$62,669	\$721,068		\$783,737	71
Los Angeles, Calif.....	324,950	845,714	\$143,029	1,313,693	21
Atlanta, Ga.....	230,529	839,328		1,069,857	45
Flint, Mich.....		136,586	98,122	234,708	33
Pontiac, Mich.....		159,620	78,473	238,093	55
Minneapolis, Minn.....		333,560	80,036	413,596	46
St. Paul, Minn.....		119,880		119,880	61
Oklahoma City, Okla.....		82,944		82,944	25
Tulsa, Okla.....		264,350	62,665	327,015	48
Portland, Oreg.....	73,374	343,827	169,314	586,515	56
Fort Worth, Tex.....	96,026	72,912		168,938	35
Houston, Tex.....	254,010	192,103	216,321	662,434	28
Seattle, Wash.....	54,785	75,596	50,743	181,124	43
Vancouver, British Columbia.....		102,419		102,419	15
Total.....	\$1,096,343	\$4,289,907	\$898,703	\$6,284,953	35

The number of mortgage items involved in this delinquent status as of December 31, 1935, was 1,764, of which 399 were from two to five payments in arrears, 1,183 were six or more payments in arrears, and 182 were already the subject of foreclosure proceedings.

Comparative amounts of properties, subject to delinquent mortgages of \$50,000 or more, for 1936 are as follows:

Classification	Amount	Parcels
2 to 5 payments delinquent.....	\$1,332,947	314
6 or more payments delinquent.....	1,112,755	354
Foreclosures.....	576,849	69
Total.....	\$ 3,022,551	737

* This aggregate is equivalent to only about one-half of the total for 1935.

Other assets represented by real estate obligations or real estate for the years 1934, 1935, and 1936 are as follows:

Character	1934	1935	1936
Second mortgages (less charge-offs).....	\$56,315	\$61,272	
Real estate contracts of sale.....	1,115,035	872,839	\$1,751,530
Real estate less liens and reserves for depreciation *.....	4,783,561	6,615,861	5,277,057
Total.....	\$5,954,911	\$7,549,972	\$7,028,587

* If the subsidiary companies of Investors Syndicate are included, the total investment in real estate would be \$12,728,131 for 1935, and \$9,776,717 for 1936. (See Appendix A-4, p. 141.)

The changes in real estate holdings for 1936, exclusive of subsidiaries, amounted to a net reduction of \$1,338,804. These changes were as follows:

Balance at Dec. 31, 1935-----	\$6, 615, 861
Acquisition during the year-----	3, 483, 723
Total-----	10, 099, 589
Sales during the year (cost)-----	\$4, 849, 914
Net adjustments account of capitalized charges, charge-offs, and depreciation-----	27, 382
	4, 822, 532
Balance at Dec. 31, 1936-----	\$5, 277, 057

For the subsidiaries of Investors Syndicate there was a net reduction in real estate holdings of \$2,951,414 in 1936. Total reductions in real estate holdings of the Corporation, including those of subsidiaries, amounted to \$4,290,218 for the year 1936.

Practically all acquisitions of real estate for the year 1936 were properties on which the Corporation had held mortgages and which had been foreclosed. Sales of these properties were effected by taking a comparatively small down payment¹⁰¹ and a mortgage for the balance. The gross sales of real estate holdings for 1936 amounted to \$5,178,415, against which there were costs of \$438,710. Profits on 249 parcels of real estate sold¹⁰² amounted to \$44,573, while losses on 1,026 parcels,¹⁰³ aggregated \$150,817. Payments for all sales were as follows:

Cash-----	\$812, 592
Trades-----	169, 489
Mortgages and contracts-----	4, 196, 334

In essence, the net result of these real estate and mortgage transactions was not the alienation of particular assets and the acquisition of new and unrelated assets, but merely that the Corporation received mortgages on real estate in lieu of ownership of the same parcels of real estate. Of course, a certain amount of cash was also received from these sales.

Table 14 shows, for the years ended December 31, 1935 and 1936, the location and book value of real estate owned.¹⁰⁴

¹⁰¹ The average down payment received was equivalent to 16% of the total purchase price.

¹⁰² There were 115 parcels in Flint, Mich., 1 in New York City, and 133 in Houston, Tex.

¹⁰³ Of these parcels, 1,008 were in 21 cities of 16 states and 18 in one Canadian city.

¹⁰⁴ Only those locations in which there are properties of the aggregate value of at least \$50,000 are shown. (Reply to the Commission's questionnaire for Investors Syndicate, Item 17 and derived from supplementary information supplied the Commission.)

TABLE 14.—*Location and book value of real estate owned by Investors Syndicate at year-ends 1935-1936*

Location	Number of parcels		Book value		Average per parcel	
	1935	1936	1935	1936	1935	1936
Birmingham, Ala.....	222	217	\$553, 172	\$559, 253	\$2, 492	\$2, 577
Little Rock, Ark.....	24	20	73, 715	65, 062	3, 071	3, 253
Los Angeles, Calif.....	158	62	1, 567, 957	1, 062, 461	9, 924	17, 136
Oakland, Calif.....	38	-----	99, 791	-----	2, 626	-----
Atlanta, Ga.....	97	103	309, 634	389, 567	3, 192	3, 782
Flint, Mich.....	65	21	226, 210	81, 951	3, 480	3, 902
Pontiac, Mich.....	94	41	342, 743	170, 190	3, 646	4, 151
Minneapolis, Minn.....	25	18	491, 620	501, 949	19, 665	27, 886
St. Paul, Minn.....	12	6	157, 161	106, 315	13, 097	17, 719
Oklahoma City, Okla.....	30	11	146, 317	66, 121	4, 877	6, 011
Tulsa, Okla.....	195	202	915, 895	927, 038	4, 697	4, 589
Portland, Oreg.....	216	117	682, 926	613, 929	3, 162	5, 247
Dallas, Tex.....	23	-----	133, 424	-----	5, 801	-----
Fort Worth, Tex.....	57	21	194, 718	85, 829	3, 416	4, 087
Houston, Tex.....	24	-----	70, 220	-----	2, 926	-----
Salt Lake City, Utah.....	13	-----	53, 171	-----	4, 090	-----
Seattle, Wash.....	112	72	379, 659	318, 481	3, 390	4, 423
Vancouver, British Columbia.....	25	16	96, 349	71, 002	3, 854	4, 438
Total.....	1, 430	927	\$6, 494, 682	\$5, 019, 148	4, 542	5, 414

Miscellaneous parcels, not included in the above list, totaled 41, with a carrying value of \$121,180 in 1935, and 75 parcels with a carrying value of \$257,909 in 1936.

These assets, representing 4,235 items of property in 1935 and 1,739 items of property in 1936,¹⁰⁵ are of slow liquidating character.

Summarized for 1935 and 1936, the book value of slow and in some measure doubtful assets of the Corporation was as follows:

Classification	Dec. 31, 1935	Dec. 31, 1936
First mortgages and deeds of trust:		
2 to 5 payments in arrears.....	\$1, 435, 950	\$1, 793, 697
6 or more payments in arrears.....	4, 465, 464	1, 450, 337
In process of foreclosure.....	1, 020, 202	681, 989
Subtotal.....	6, 921, 616	3, 926, 023
Second mortgages.....	61, 272	1
Real estate.....	6, 615, 861	5, 277, 057
Contracts for the sale of real estate.....	872, 839	1, 751, 530
Total.....	\$14, 471, 588	\$10, 954, 611

These totals are equal to 20.7% and 12.6%, respectively,¹⁰⁶ of the \$69,990,000 year-end gross assets of the Corporation for the year 1935 and \$87,092,000 for the year 1936.¹⁰⁷

¹⁰⁵ Not including second mortgages and contracts for the sale of real estate.

¹⁰⁶ Excluding mortgage endorsements and contingent liabilities.

¹⁰⁷ Book figures.

J. Classification of Investments in Bonds, Stocks, and Other Securities

Investments in bonds, stocks, and other securities, exclusive of investments in the stocks of wholly-owned subsidiaries, were carried at cost of \$22,125,891 at December 31, 1936, and had a market value of \$23,003,596 at this date. The following table of securities investments shows the amount of each class of security, the ratio of each item to the total of security investments, and the ratio of each item to the total assets of the Corporation.¹⁰⁸

Security	Amount	Percent of total security investments	Percent of total assets
U. S. Government bonds.....	\$6, 111, 307	27. 62	6. 72
State, county, and municipal bonds.....	3, 082, 846	13. 93	3. 39
Railroad bonds.....	1, 702, 202	7. 69	1. 87
Public utility bonds.....	4, 601, 153	18. 09	4. 40
Industrial bonds.....	1, 225, 839	5. 54	1. 35
Canadian Government, Provincial, and municipal bonds.....	1, 159, 474	5. 24	1. 28
Canadian corporation bonds.....	1, 337, 979	6. 05	1. 47
Preferred and guaranteed stocks.....	3, 505, 091	15. 84	3. 86
Total.....	\$22, 125, 891	100. 00	24. 34

The Corporation held in 1936 mortgages guaranteed by the Federal Housing Administrator. At the year-end 1936 the amount of such mortgages was \$14,826,034, at cost, with a market value of \$15,122,555.¹⁰⁹

K. Ratio of Gross Income, Operating Expenses, Etc., to Average Total Assets ¹¹⁰

The results of the operations of the Corporation, for the years 1929 to 1936 ¹¹¹ and for that period, expressed in percentages of average total assets, broken down as to gross income,¹¹² operating expenses, including net appropriations to reserves and interest paid, and profit and loss are given in Table 15.

¹⁰⁸ See Appendix A-1 (Annual Report of Corporation for 1936), p. 137.

¹⁰⁹ Ibid.

¹¹⁰ See Appendix K, p. 153, for a detailed tabulation of these items.

¹¹¹ The years 1927 and 1928 are omitted because of lack of comparative data.

¹¹² This item is divided into (a) income, excluding initial payment receipts, and (b) initial payment receipts—part of installment certificate payments.

TABLE 15.—*Operating results of Investors Syndicate, 1929-1936*

Year	Gross income as a percent of average total assets			Operating expenses, appropriations to reserves, interest, and profit and loss as percent of average total assets			
	Income excluding initial payment receipts	Initial payment receipts	Total gross income	Operating expenses ^a	Appropriations to reserves, interest, etc. ^a	Profit (loss)	Total operating expenses, appropriations to reserves, interest, and profit and loss
1929.....	7.40	14.97	22.37	13.00	7.28	2.09	22.37
1930.....	7.07	12.04	19.11	10.32	8.32	.47	19.11
1931.....	6.99	8.29	15.28	7.55	7.06	.67	15.28
1932.....	6.39	5.53	11.92	7.91	3.87	.14	11.92
1933.....	5.43	3.81	9.24	6.23	3.66	(.65)	9.24
1934.....	6.01	3.61	9.62	5.17	4.41	.04	9.62
1935.....	6.36	4.56	10.92	5.64	4.88	.40	10.92
1936.....	7.27	4.78	12.05	5.81	5.36	.88	12.05
Period.....	6.57	6.25	12.82	7.07	5.32	.43	12.82

^a Excludes "net appropriations to reserves," and interest paid.

From the foregoing table it appears that initial payment receipts were necessary in order to meet sales commissions, other procurement expenses, operating expenses, improvement and interest obligations, and appropriations to reserves. Hence, in each of the years covered by Table 15 it was necessary for the corporation to take initial payment receipts into income. "Initial Payment Receipts" represent that portion of payments made by certificate holders during the first and second years that are not set aside in reserves and liability accounts. The cost to the Corporation of improving contract liabilities and reserves after the period of deducting "Initial Payment Receipts" is completed must therefore be met out of other income sources.¹¹³

Direct selling costs, as represented by commissions paid on sales, amounted to \$16,936,000 for the years 1929 to 1936, and all other expenses of operation except the cost of improvement of reserves applicable to outstanding certificates amounted to \$11,904,000.

The company has made the following statement describing its operating experience:

Under the company's plan of operation it is not contemplated that the investment income will cover certificate interest requirements as well as selling costs and general overhead expenses. The selling costs and a substantial amount of the overhead are derived from payments made by certificate holders. The cost allowance derived from such payments is represented by the income account, "Initial Payment Receipts."

To illustrate further the necessity of initial payment receipts to the Corporation, certain ratios have been computed showing what the operating experience would have been if such initial payment receipts had not been used. The figures show percentages of average total

¹¹³ See Appendix K, p. 153, for a detailed analysis of ratios, of income and expenses, etc.

assets, income received (exclusive of initial payment receipts, i. e., appropriations from certificate principal installments paid by certificate holders), column (2); operating expenses and the cost of improvement of reserves, column (3); and income deficiency excluding initial payment receipts, column (4); and the deficiency as a percentage of the income (as qualified), column (5):

(1) Year	(2) Percent of Average Total Assets Income (ex- cluding initial payment re- ceipts)	(3) Operating ex- penses and cost of im- provement of reserves	(4) = (3) - (2) Income de- ficiency (exclusive of initial pay- ment re- ceipts)	(5) Additional In- come Required as percent of income Re- ceived (ex- cluding initial payment Re- ceipts)
1929.....	7.40	20.28	12.88	174.05
1930.....	7.07	18.64	11.57	163.65
1931.....	6.99	14.61	7.62	109.01
1932.....	6.39	11.78	5.39	84.35
1933.....	5.43	9.89	4.46	82.14
1934.....	6.01	9.58	3.57	59.40
1935.....	6.36	10.52	4.16	65.41
1936.....	7.27	11.17	3.90	53.65
Period.....	6.57	^a 12.39	^a 5.82	^a 88.58

^a The amount of unamortized procurement costs (initial payment receipts deductions from installment payments) at Dec. 31, 1936, was \$14,005,000. The deduction of this sum from the period total of operating expenses and improvement of certificate reserves, produces period percentages as follows: column (3), 8.97%, column (4), 2.40%, and column (5), 36.50%.

Thus it appears that were it not for the high rate of lapses and surrenders before maturity by certificate holders, and the appropriation to income of early payments made by all certificate holders, all of which are losses to certificate holders and inure to the benefit of the Corporation's income, the Corporation would not have enough income to meet its certificate obligations and otherwise carry on its business. In other words, the Corporation has been able to meet reserve improvement costs and principal obligation on its outstanding certificates by virtue (1) of the fact that many holders of the certificates have permitted their certificates to lapse or have surrendered their certificates at a time when the surrender value of the certificate has been less than the amounts paid in by these certificate holders and have thus relinquished all claims to initial payment receipts; (2) the savings to the Corporation resulting from the high percentage of delinquency of its contract holders, during which periods of delinquency the reserves maintained are not required to be improved. The Corporation estimates that the so-called "stretch out" or delinquency saves the Corporation from 25% to 30% annually of its cost of improving reserves were there no such delinquencies. The Corporation has applied this difference between amount paid in and the surrender value as "income," which "income" is also used to meet the Corporation's obligations on the outstanding certificates and its operating expenses. Without thus supplementing its "income," the Cor-

poration could not meet its operating expenses, including salesmen's commissions and certificate obligations.¹¹⁴

L. Net Worth of Investors Syndicate

At December 31, 1936, the net worth of the Corporation, according to its books, was \$2,116,710, and was therefore equal to only 2.7% of the Corporation's total liabilities of \$78,294,062,¹¹⁵ according to the books of the Corporation.

X. INCOME, EXPENSES, AND DIVIDENDS

A. General

The principal sources of the income of the Corporation were (a) the income on its investments, consisting of interest on mortgages and bonds and dividends on stocks, and (b) the "initial payment receipts," that is, that part of the installment payments by certificate holders which is taken into income by the Corporation for the purpose of paying commissions and other procurement costs.

For the 10-year period 1927-36, the Corporation received \$25,092,000 as income from interest and dividends on investments, and \$4,412,000 as "Collection Revenue," and miscellaneous items, or an aggregate of \$29,504,000. "Collection Revenue" represents the added amount charged by the Corporation on monthly, quarterly, and semiannual installment payments over and above the amount of installment payments on an annual basis. "Collection Revenue" covers (a) equalization of interest between annual and less than annual installment payments, and (b) the additional cost incident to handling collections of such lesser installments. The total of these receipts exceeds the \$23,108,000 aggregate of the total "net appropriation to reserves" from income (needed to meet the required improvement to contract liabilities and reserves) and other certificate interest by \$6,396,000. This amount, \$6,396,000, is therefore the measure of income from the named sources which was available to meet the operating expenses for the period. Initial Payment Receipts amounting to \$25,546,000 (1929-1936) were, therefore, used to pay direct selling commissions and other procurement costs and a substantial portion of other operating expenses, leaving a balance of \$2,052,000, which is the amount of net profit of the Corporation for the period.

The following table is a summary of income and expenses of the Corporation for the period 1927-36:¹¹⁶

¹¹⁴ An audit report by the Auditor of State of the State of Iowa, as of November 30, 1934, referred to the fact that the amount of excess reserve has been gradually diminished from 26.64% as of December 31, 1929, to 1.62% as of November 30, 1934, and characterized the trend as serious.

¹¹⁵ Not including contingent liabilities.

¹¹⁶ Appendix B, p. 142, contains a condensed statement of income and expenses of the Corporation for the period 1927-36.

Income:

Initial payment receipts (1929 to 1936)-----	^f \$25,546,000
Other income, namely—	
Interest received-----	\$23,376,000
Dividends received-----	1,716,000
Collection revenue-----	2,349,000
Commissions received-----	433,000
Transfers and duplicate fees-----	83,000
Profit on sale of bonds-----	^a 1,025,000
Real estate income and expense-----	^b 370,000
Stamp tax refund-----	^c 122,000
Miscellaneous-----	30,000
	<hr/> 29,504,000
Total income-----	55,050,000
Expenses (before appropriations to certificate reserves of \$20,327,000):	
Commissions (1929 to 1936)-----	^d 16,936,000
Other expenses, namely—	
Certificate interest—miscellaneous-----	^e \$2,781,000
Other certificate expense-----	1,854,000
Salaries-----	3,136,000
Mortgage and loan agency expense-----	1,235,000
Real estate income and expense-----	^b 1,730,000
Loss on sale of bonds-----	^a 267,000
Stamp tax paid-----	^c 212,000
Loss on sale of real estate-----	732,000
Rent-----	236,000
Taxes-----	407,000
Depreciation—furniture and fixtures-----	170,000
Depreciation—real estate-----	368,000
Other expenses-----	2,393,000
Profit and loss adjustments-----	214,000
	<hr/> 15,735,000
Total expenses-----	<hr/> 32,671,000
Income available for appropriations to certificate reserves-----	22,379,000
Net appropriations to certificate reserves-----	20,327,000
	<hr/>
Net profit and loss credited to surplus-----	2,052,000

^a Net profit, \$758,000.^b Net expense, \$1,360,000.^c Net payment, \$90,000.

^d Practically all commissions on sales were paid by the Corporation to its subsidiary, Installment Security Agency, Inc., up to June 30, 1934. At that time this subsidiary, which had theretofore been the employer of the salesmen of the Corporation, abandoned that function through the termination of its sales agency agreement, and the only commissions which have been since paid to it are those applicable to certificates sold by or through it prior to the termination date. The other functions performed by the subsidiary, such as advertising and the like, have been continued since June 30, 1934. These facts are noted here so that it may be understood that, since the figures discussed above are applicable only to the Corporation, the actual amounts and nature of expenses would vary somewhat from those indicated. For example, the Corporation had advertising expenses of \$141,508 for 1935, and \$170,811 in 1936, which do not appear in the above classification of expenses as such but are reflected instead in the item shown as commissions. Understated an unknown amount which Corporation estimates as some \$5,000,000.

^e Interest paid or accumulated on advance installment payments, coupon interest on annuity contracts and other miscellaneous certificate interest.

^f Understated an unknown amount which Corporation estimates as some \$5,000,000.

B. Effect of Initial Payment Receipts and the Penalty Provisions

As has been indicated, the total income of Investors Syndicate for the period 1927 to 1936 amounted to \$29,504,000, not including, after 1929, Initial Payment Receipts amounting to \$25,546,000.

The total operating expenses, excluding direct selling commissions and cost of improving reserves, amounted to \$12,954,000. Total operating expenses excluding direct selling commissions¹¹⁷ but including cost of improving reserves amounted to \$36,062,000. Hence, it is apparent that operating and procurement expenses, other than direct selling commissions, in the amount of \$6,558,000 had to come from Initial Payment Receipts.

Initial Payment Receipts, as income or expense benefits, are supplemented by (a) amounts recovered from reserves for lapsed certificates and certificates surrendered by the holders before they are entitled to a cash surrender value equal to or greater than the sums paid in; and (b) the productive value represented by the use of the funds in the reserves. Benefits to the Corporation from delinquencies come from the suspension of improvement on certificates during periods when such certificates are delinquent, i. e., when their holders are in arrears in their installments, thus giving the Corporation the use of such funds without improvement cost during such periods of delinquency. However, Initial Payment Receipts from installment payments of persistent certificate holders who do not surrender their certificates until cash surrender values exceed installment payments made by them, may be deemed as ultimately lost to the Corporation either in part or in entirety, as the case may be, through interest or other service credits to such certificates.

C. Appropriations to Income From Certificate Reserves

The certificate reserve account expanded from \$1,187,729 on January 1, 1927, to \$6,681,043 on December 31, 1936, a total increase in amount of \$5,493,314.

¹¹⁷ When sales are on a constantly and substantially increasing basis, as has been the condition in this case, operating expenses are considerably increased, relatively, because commissions paid to salesmen and other procurement costs are in effect deducted from certificate holders' installment payments of the first two years, which deductions are credited to income as initial payment receipts. Of course, to the extent certificate holders continue installment payments, such deducted amounts have to be restored or returned to their credit (by charges against income) through increases in cash surrender value liabilities. The time of complete restoration (cash surrender values being equal to payments by certificate holders) varies from 5 years to 7 years, according to the series of certificates involved, and in the method of payment.

The extent to which installment payments are applied to the certificate reserve account for the first two years of the life of the certificates is illustrated as follows:¹¹⁸

Installment payments, \$120 per annum.....	\$240. 00
Cash surrender value at end of second year.....	134. 00
Amount credited to income as "initial payment receipts".....	106. 00
"Initial payment receipts" are applied as follows:	
Sales commissions.....	\$52. 50
Credit to "Certificate Reserve".....	10. 00
Balance not specifically applied.....	43. 50
	106. 00
Of the payments, expressed in percentages, there is allocated to—	<i>Percent</i>
Cash surrender value.....	55. 8
Sales commissions.....	21. 9
Credit to income.....	22. 3

As the credit to "Certificate Reserve" is equal to 4.2%, the balance in income not specifically applied, 18.1%, is available for general improvement requirements of outstanding certificates and other operating purposes.

D. Cost of Improving Reserves to Mature Certificates

The cost of improving reserves to mature certificates outstanding for the 10-year period ended December 31, 1936, was equal to 5.44% of the average total contract liabilities and reserves of such certificates.

By the elimination of initial payment receipts from income and selling commission from expenses the Corporation actually earned 3.89% based upon the average total contract liabilities and reserves of certificates.

As shown by Table 15, Section IX, K *supra*, the Corporation's average gross investment income (does not include initial payment receipts) was equal to 6.57% of average total assets, 1929-1936, with operating expenses (selling commissions excluded) and interest on and improvement to certificates of 7.07% of such average total assets.¹¹⁹

E. Dividends Paid by Corporation on its Capital Stock

As has been noted,¹²⁰ the capital stock (both preferred and common) of the Corporation was not publicly offered from 1927 to 1936 and at December 31, 1936, was closely held by a few persons. A substantial

¹¹⁸ The illustration is based on the certificates being issued at the end of 1936.

¹¹⁹ Appendix B, p. 142, contains an analysis of the income of the Corporation by years for the period 1927 to 1936. Since the preparation of this material, an analysis of the surplus account prepared by the Corporation's staff has been received by the Commission. This account showed special credits, debits, and adjustments for prior years. On a year-to-year basis some changes, largely immaterial, would be effected in the results shown in the analysis by the application of the figures from the surplus account. For the period such total credits amounted to \$2,140,426 and total debits \$2,064,109. The difference, only \$76,317, while it should be noted, is negligible in comparison with totals shown in the analysis; certainly this amount is too small to affect the accuracy of the factor determination reflected therein.

¹²⁰ See *supra*, Sec. II, *Capitalization*, p. 5.

portion of both the preferred and common stock has been held by the officers and directors of the Corporation and their associates.¹²¹ Dividends have been paid from time to time on the capital stock of the Corporation. Concerning the history of the dividends paid from 1927 to 1935, the Corporation stated:¹²²

None of the earnings of 1927 and 1928 were distributed as cash dividends, although in April 1927 and again in January 1928, \$100,000 and \$300,000, respectively, of surplus account was transferred to the capital stock account in the form of stock dividends.

The Corporation began to pay quarterly dividends on its stock in 1929, and from January 30, 1929, to April 1, 1931, quarterly dividends were paid, 5% being paid in cash and 5% being paid in preferred stock. The stock distribution was discontinued June 30, 1931, and the cash dividend was discontinued after the payment of the March 30, 1932, dividend. This change of policy was due to the increasing gravity of the economic depression. No further dividends of any kind were paid during the period.

Dividends, both stock dividends and cash dividends, were paid on the capital stock of the Corporation as follows:¹²³

Year	Capital stock dividends (par value)	Cash dividends
1927, preferred.....	\$100,000	\$300,000
1928, common.....	300,000	None
1929, preferred.....	78,813	78,812
1930, preferred.....	91,235	91,235
1931, preferred.....	68,680	142,553
1932.....	None	73,870
1936, preferred.....	147,500	39,019
Total.....	786,228	725,489

The data available from the analysis of the surplus account referred to above do not show separately cash dividends paid on preferred stock and on common stock. The stock dividends referred to in the above quotation represent a capitalization of surplus. In effect, therefore, that amount of earnings was not paid out but was retained in changed form in the business.

F. Compensation of Officers, Directors, and Others¹²⁴

Compensation paid to officers and directors amounting to \$10,000 or more in the case of any one individual (consolidated for the Corporation and all subsidiaries) was as follows:

¹²¹ It is again emphasized the capital stock of the Corporation must be distinguished from the installment investment certificates which are sold to the public.

¹²² Reply to the Commission's questionnaire for Investors Syndicate, Item 16.

¹²³ Ibid.

¹²⁴ Reply to the Commission's questionnaire for Investors Syndicate, Item 10.

Particulars	1927	1929	1931	1933	1935	1936
Number of persons paid \$10,000 or more.....	4	4	7	6	7	8
Total amount.....	\$50,365	\$63,664	\$134,204	\$115,980	\$110,979	\$189,435
Highest amount.....	15,750	29,000	• 37,681	23,750	22,000	29,859

• This represents salary and commissions for one director.

The salary of the president of the Corporation was \$15,750 in 1927, \$29,000 in 1929, \$30,000 in 1931, \$23,750 in 1933, \$22,000 in 1935, and \$27,300 in 1936.

Compensation of \$10,000 or more to any one individual, paid to employees other than officers and directors for the years shown, was as follows: ¹²⁵

Particulars	1929	1931	1933	1935
Number of persons paid \$10,000 or more.....	5	5	3	3
Total amount.....	\$139,555	\$90,959	\$49,521	\$50,980
Highest amount.....	• 46,323	35,692	19,743	18,977
Second highest amount.....	• 39,872	18,461	18,178	17,003
Total as commissions.....	82,669	23,692	19,743	17,003

• Includes bonus for services performed in 1928.

Compensation of \$10,000 or more to any one individual paid to others than officers, directors, and employees of the Corporation is summarized as follows: ¹²⁶

Capacity	1927	1929	1931	1933	1935
Attorneys.....		\$11,838	• \$25,488	• \$69,074	\$44,561
Accountants.....	\$15,696	12,250	12,750	15,499	15,436
Depository.....					10,135
Total.....	15,696	24,088	38,238	84,573	70,132

• Paid to 2 firms.

• Paid to 4 firms.

G. Income of Subsidiary Corporations ¹²⁷

The five wholly-owned active subsidiaries had gross and net income for the years 1935 and 1936, as follows:

Subsidiary	1935		1936	
	Gross income	Net income (deficit)	Gross income	Net income (deficit)
Investors Syndicate Title & Guaranty Co.....	\$398,525	\$46,266	\$381,829	\$27,786
Southwestern Mortgage Investment Corporation..	555,824	(81,767)	361,335	(15,145)
Southern Mortgage Loan Co.....	153,844	14,453	79,276	(431)
Jefferson Mortgage Co.....	(•)	(•)	118,220	6,499
Installment Securities Agency, Inc.....	581,176	124,332	667,346	115,529

• No data.

¹²⁵ Id., Item 8.

¹²⁶ Id., Item 11.

¹²⁷ Id., Item 50.

Expressed in percentages of the Investors Syndicate's investment in Investors Syndicate Title & Guaranty Company amounting to \$375,000,¹²⁸ the net income of the latter company was equal to 12.34% in 1935 and 7.41% in 1936 of such investment. No dividends were paid by the subsidiary.

The losses of the Southwestern Mortgage Corporation were largely a result of the excess of depreciation and operating expenses of real estate owned by the company over income therefrom.

The income and expenses of the Southern Mortgage Loan Company practically counterbalance, its income being mortgage interest from Southwestern Mortgage Investment Corporation, and its expenses consisting almost entirely of mortgage interest paid to the Reconstruction Finance Corporation. Most of the profits in 1935 of the Southern Mortgage Loan Company were realized on the sale of bonds.

The Jefferson Mortgage Company showed an excess of \$6,500 of income over expenses for 1936. Its income consisted largely of rents from real estate with some other incidental income.

The profits of Installment Securities Agency, Inc., have, from June 30, 1934, been derived principally from activities in behalf of the Corporation, such as advertising, general agency matters, and the like. Profits realized are currently passed on to the Corporation, its parent, in the form of dividends.

XI. THE EXPERIENCE OF INVESTORS

During the period 1927-1936 the experience of the majority of certificate holders, i. e., those whose certificates lapsed and those who surrendered their certificates before the cash surrender values equaled the sum paid by them to the Corporation, appears to have been unsatisfactory.¹²⁹

The certificate holders who have paid their installments to maturity have upon maturity received the maturity amount named in the certificates.¹³⁰ To a very limited degree payment has been made by the Corporation in the form of deferred installments, under optional settlement conditions of certificates. Holders of certificates which matured were a small minority as compared to holders of certificates which were otherwise terminated. Most of the holders, for one reason or another, have terminated their status as certificate holders prior to maturity, either by allowing their certificates to lapse through non-payment of installments before the attainment of cash surrender values, or by surrendering their certificates to the Corporation for the cash surrender values they could realize on these certificates.¹³¹ It is these holders whose experience as investors has been unsatisfactory.¹³²

¹²⁸ This item consists of \$250,000 capital and \$125,000 surplus.

¹²⁹ Because of the fact that additional data have been furnished the Commission by the Corporation since the publication of Part Two of the Report on Investment Trusts and Investment Companies, the figures in this section do not necessarily agree with those contained in Part Two of the over-all report.

¹³⁰ Reply to the Commission's questionnaire for Investors syndicate, Item 31.

¹³¹ As is evident, most surrendered certificates were surrendered before the cash surrender values equaled the total payments made by certificate holders.

¹³² See Appendix C, p. 144.

A. Experience of Holders of Securities to Maturity ¹³³

Table 16 compares the aggregate redemption value of matured certificates with the aggregate sum paid by holders of such matured certificates for the years 1927 to 1936.¹³⁴

TABLE 16.—*Aggregate redemption values of matured certificates and payments on such certificates, 1927-1936*

Year	Aggregate amount paid by certificate holder	Aggregate redemption value	Percent of redemption value to payment by certificate holder	Year	Aggregate amount paid by certificate holder	Aggregate redemption value	Percent of redemption value to payment by certificate holder
1927.....	\$962, 450	\$1, 285, 850	133. 6	1933.....	\$2, 905, 750	\$3, 920, 800	134. 9
1928.....	555, 350	750, 500	135. 1	1934.....	3, 017, 250	4, 034, 300	133. 7
1929.....	988, 650	1, 336, 000	135. 1	1935.....	3, 141, 800	4, 204, 300	133. 8
1930.....	2, 405, 450	3, 250, 600	135. 1	1936.....	3, 740, 900	5, 059, 000	135. 2
1931.....	2, 719, 500	3, 674, 950	135. 1				
1932.....	2, 659, 050	3, 594, 700	135. 2		23, 096, 150	31, 111, 000	134. 7

This table indicates that the minority of holders of certificates—those who made all the payments required to maturity—invested approximately \$23,000,000, received approximately \$31,000,000 from the Corporation, and therefore realized an aggregate gain of approximately \$8,000,000.

Precise figures as to the experience of holders, other than the holders of matured certificates, were not available. No data were supplied to the Commission by the Corporation as to all payments by and to all certificate holders. This total amount of all payments was resolved in the manner indicated in Appendix C.

B. Shrinkage and Losses to Certificate Holders

The experience of all investors, for the period 1927-1936, has been determined according to three major classes. A computation has accordingly been made, based on the material supplied the Commission by the Corporation, to estimate the experience of all investors for this period. For certificates in force December 31, 1936, the amount is based upon the hypothetical surrender, as of that date, of such certificates for their then cash surrender values. The computation takes the reserve values of all certificates at the beginning of the period plus all payments by certificate holders during the period, and compares the result with all payments to certificate holders during the period plus the total of cash surrender values and advance payments immediately available to certificate holders at the end of the period. Additional reserves—i. e., contract and certificate reserve and contingent liability reserve, consisting of interim installment payments—held by the Corporation at the end of the period, have

¹³³ It must be recalled that the majority of holders do not hold their certificates until they have matured.

¹³⁴ Reply to the Commission's questionnaire for Investors Syndicate, Item 35.

not been included in the computation because these reserves, as represented by the Corporation, were not immediately available to certificate holders in cash at the end of the period. The results of this computation are shown in the following table:

(1) Cash surrender values, interim installment payments, advance payments and other contract and certificate reserves plus estimated unamortized selling costs (\$1,500,000) at January 1, 1927-----	\$16, 693, 000
(2) Amount paid in by certificate holders January 1, 1927, to December 31, 1936-----	138, 865, 000
	<u>155, 558, 000</u>
(3) Amount paid to certificate holders on:	
b. Surrendered Contracts-----	29, 005, 000
a. Matured Contracts-----	\$31, 111, 000
Total paid to all certificate holders January 1, 1927, to December 31, 1936-----	60, 116, 000
	<u>95, 442, 000</u>
Cash Surrender Values and Advance Payments on all contracts in force December 31, 1936-----	65, 229, 000
(4) Difference, representing hypothetical shrinkage on contracts and certificates in force December 31, 1936, and net total capital loss to certificate holders on lapsed and surrendered certificates during the period (note)-----	30, 213, 000

NOTE.—If the contract and certificate reserve and interim installments payments (contingent liability reserve) as at December 31, 1936, were available to the contract and certificate holders on demand, which, however, they are not, the hypothetical shrinkage, and the loss above shown would be reduced by \$18,343,000 to \$11,870,000.

(1) The actual amount paid in on contracts and certificates in force at January 1, 1927, could not be ascertained from data furnished by the Corporation. However, the reserves as of that date have been increased by an estimate as indicated, for applicable net unamortized procurement costs.

(2) Includes Corporation's estimate of \$5,150,000 to offset the effect in other figures of commission deductions from some installment receipts, as a matter of accounting procedure and convenience.

(3) Subject to the right of reinstatement, holders of lapsed contracts lose the entire amount of payments made. Therefore payments shown above were on matured and surrendered contracts only.

(4) This does not include loss to all contract and certificate holders during periods of delinquency when value of contract holder's interest is not increased and when improvement of reserves is suspended. And there is other interest sacrifice hereinafter referred to.

It thus appears that the total hypothetical principal or capital shrinkage that would have occurred had all certificates in force at December 31, 1936, been cancelled or surrendered on that date, plus the actual losses which occurred upon lapses and surrenders during the period 1927-1936 was \$30,213,000. The experience of investors may be broken down into three categories, (1) those who terminated their certificates by maturity during the period, (2) those who terminated during the period by lapse or surrender before maturity, and (3) those who held certificates in force at the end of 1936. Figures are available to show the actual experience of holders of certificates

which matured during the period, and the hypothetical experience for certificates in force at December 31, 1936, and the actual experience for lapsed certificate holders and surrendered certificate holders, affected in part by an estimate by the Corporation. On this basis the net aggregate of \$30,213,000 includes a gain of \$8,016,000 to matured holders who had paid in only \$23,095,000 and had received back at maturity \$31,111,000; a hypothetical shrinkage of ¹³⁵ \$28,902,000 to certificates in force at December 31, 1936, against which total certificate payments by certificate holders amounted to \$94,131,000 compared to cash surrender values of \$65,229,000; and a loss of \$9,337,000 to lapsed and surrendered certificate holders (subject to right of reinstatement available to holders of lapsed certificates), which holders had paid in \$38,342,000 and received—surrendered certificate holders—\$29,005,000.

Reduction in cost to the company due to delayed or delinquent payments has not been included in the foregoing calculations. Data are not available upon which to base an accurate estimate of such cost reduction, but such estimates as have been made indicate that it would amount to approximately \$9,200,000 for the ten-year period. This amount divides: (a) all certificates \$5,700,000 and (b) lapsed and surrendered certificates, \$3,500,000 representing interest sacrifice, in comparison with depositors in savings banks.

C. Lapsed and Surrendered Certificates

Data furnished by the Corporation for the 9-year period 1927–1935 show that the ratio of face amount of the certificates which lapsed ¹³⁶ and those which were surrendered before maturity to the face amount of all certificates issued during the period was 44.42%. ¹³⁷ The following table summarizes the lapses and surrenders of certificates for the period from January 1, 1927, to December 31, 1936:

Face or maturity amount of certificates in force at Dec. 31, 1926__	\$106, 437, 500
Total maturity or face amount of certificate issued from Dec. 31, 1926, to Dec. 31, 1936_____	994, 270, 050
Total_____	1, 100, 707, 550
Face amount of certificates which matured, including death losses for period _____	30, 837, 341
Face or maturity amount of certificates which would have been in force at Dec. 31, 1936, had there been no lapses or surrenders___	1, 069, 870, 209
Face or maturity amount of certificates in force Dec. 31, 1936_____	625, 449, 067
Face or maturity amount of certificates which lapsed and were surrendered during the period_____	444, 421, 142
Ratio of face amount of lapses and surrenders during the period to amount of certificates which would have been in force at Dec. 31, 1936, had there been no lapses and surrenders_____	41. 54%

¹³⁵ The difference of \$28,902,000 consists of unamortized procurement costs of \$14,005,000 less improvements of \$3,446,000 in value of certificates in which cash surrender values and other reserves exceed payments by certificate holders, net \$10,559,000, plus other certificate reserves of \$18,343,000.

¹³⁶ Such certificates carry reinstatement rights.

¹³⁷ Reply to the Commission's questionnaire for Investors Syndicate, Item 31. The ratio 44.42% is simple, not weighted.

The Corporation has compared its lapse ratio of 41.54% for the 10-year period to the ratios of lapses and surrenders for three life insurance companies on life insurance contracts which showed ratios for the same period of 42.6%, 47.9%, and 54.6% ¹³⁸ according, as the company alleges, to Best's Reports. Best's 1937 Life Insurance Reports, commenting on its formula for determining these ratios, states: ¹³⁹ "The ratio is for lapses after the first year. The first year lapse is double the published rate."

Terminations for the three insurance companies used in the comparison, according to statistics published in the Life Insurance Year Books ¹⁴⁰ show ratios for these companies, including lapse and surrender ratios, for the period 1927 to 1935 as follows:

Terminations	Percent of total terminations					
	No. 1		No. 2		No. 3	
By death.....	9.9		6.4		4.3	
By maturity ^a	1.1		1.3		.5	
By expiry.....	6.6		11.0		5.8	
By surrender.....	48.5		38.7		30.5	
By lapse.....	33.9	82.4	42.6	81.3	58.9	89.4
Total.....	100.0		100.0		100.0	

^a Matured endowments and annuities.

The lowest combined surrender and lapse percentage for any year was 74% while the highest was 91%. The annual variations, low to high, for the three companies were: No. 1, 80% to 84%; No. 2, 74% to 86%; and No. 3, 87% to 91%.

With respect to Investors Syndicate, it is significant that the amount of the certificate maturities—fully matured certificates—of the Corporation plus death and disability maturities amounted to \$30,837,341 for the 10-year period 1927–1936, or about 29% of the total of \$106,437,500 of face amount of certificates in force at the beginning of the period. Under the prevailing arrangements, two years must elapse from the date of the last installment payment before a certificate is deemed lapsed by the Corporation—the holder must be in default in an installment payment for two years before certificate is lapsed.¹⁴¹ A single installment payment prior to the expiration of two years following the last payment (during the two-year default grace period) has the effect of extending the period of grace for another two years from the date of such payment. For example, 10 installment payments each made at regular two-year intervals but amounting in all to the sum of only 10 monthly installments would maintain a certificate in active status for a period of 20 years.

¹³⁸ These figures on insurance lapses were taken by the company from *Best's Reports*, (Reply to the Commission's questionnaire for investors Syndicate, Item 31.)

¹³⁹ *Best's Life Insurance Reports*, 1937, at p. xxi.

¹⁴⁰ Life Insurance Year Books (Spectator Company) for the years 1927 to 1935, inclusive.

¹⁴¹ Certificates terminated before attainment of cash surrender values are termed lapses, while certificates terminated after attainment of cash surrender values are termed surrenders.

No data are available as to the maturity period of the various face or maturity amounts of certificates actually issued for the period studied. Specimen copies of the certificates indicate maturities in periods of 10 and 15 years, although up to August 1932 only 10-year certificates were issued. It therefore follows that all certificates which matured during the period up to 1936, including a relatively small amount for death and disability maturities, had to be in force at January 1, 1927. Since total maturities for the 10-year period were about 29% of the face amount in force at January 1, 1927, the beginning of the period, the lapses and surrenders approximate a total of 71% of face amount of all certificates in force at January 1, 1927. The following schedule summarizes the method by which this percentage was derived:

Maturity amount of certificates in force at Jan. 1, 1927 ^a -----	\$106, 437, 500
Face amount of certificates which matured, including death losses from Jan. 1, 1927, to Dec. 31, 1936 ^a -----	30, 837, 341
<hr/>	
Balance, as unmatured certificates which on an average basis represent surrendered and lapsed certificates-----	75, 600, 159
Ratio of surrendered and lapsed certificates to all certificates in force Jan. 1, 1927-----	71%

^a Reply to the Commission's questionnaire for Investors Syndicate, Table 19.

The indicated ratio of 71% is a minimum ratio, as there were exits of certificates by lapse and surrender prior to January 1, 1927, which certificates were sold concurrently with certificates which matured between January 1, 1927, and December 31, 1936.

An actual analysis of the persistency experience of certificates sold in the State of Texas ¹⁴² was submitted as a sample by the Corporation. Persistency experience means essentially the persistence with which holders made their payment or the lapse and surrender record of the certificates sold. Using this actual persistency experience as a basis or yardstick, an estimate may be made of the persistency experience of all certificates issued in all states by the Corporation. All certificates issued in all states during 1934, 1935, and 1936 aggregated \$319,807,000 in face amount, but these certificates were not appreciably affected by lapses, since a lapse does not take effect until two years after the payment of an installment, and the first payment necessarily was not made on these certificates before 1934. Thus, only those certificates which were defaulted prior to December 1934 could possibly lapse during the period. These certificates were not affected by surrenders during these years except to a negligible degree, since the certificates had no surrender value the first 18 months. Surrenders for certificates issued during 1934 amounted to 4.2% for the period.¹⁴³ Since the certificates sold prior to 1932 were for a 10-year term and those written since then have been of a 15-year term, it is obvious that the percentage of surrenders will increase with the passage of time. Illustrative of the tendency is the fact that the certificates sold during 1930 through 1935 had a lapse and surrender ratio for 1930 of 68%, while on the same basis the ratio for certificates sold in 1929

¹⁴² See Appendix E, p. 146.

¹⁴³ Ibid.

was 73.5%.¹⁴⁴ Taking the percentage figure of 68% as the percentage of lapses and surrenders which may be expected to eventuate, the potential lapses and surrenders for the entire period, over and above the actual lapses and surrenders which have taken place, may be estimated.

Taking the actual persistency experience of certificates sold in the State of Texas as the yardstick of the actual lapses and surrenders of all certificates sold in all states, potential lapses and surrenders at December 31, 1936, of certificates sold from 1932 to 1936 are indicated to be as follows:

Year	Actual experience ratio of lapses and surrenders of Texas certificates ^a		Potential lapses and surrenders of certificates sold in Texas (percent) ^a	Potential lapses and surrenders (in dollars) face amount of all certificates
	6-year ^b (percent)	Expired ^a (percent)		
1932.....	68	51.9	16.1	\$13,099,000
1933.....	68	35.8	32.2	23,796,000
1934.....	68	30.3	37.7	44,409,000
1935.....	68	4.2	63.8	97,276,000
1936.....	68	0	68.0	113,789,000
Total remaining potential lapses and surrenders.....				292,369,000

^a Ratio of face amount of lapses and surrenders to face amount of certificates sold.

^b Persistency ratio for period 1930-35 of certificates sold in Texas in 1930.

^c Percent of certificates sold in indicated year which expired in the period.

This face amount, \$292,369,999, of potential lapses and surrenders, subject to the above qualifications, for the years 1932-1936, added to the cumulative actual lapses and surrenders for the 10-year period ended December 31, 1936, of \$444,421,000,¹⁴⁵ makes a total face amount of \$736,516,000 of actual and ultimate lapses and surrenders of certificates sold in this period. This aggregate face amount of lapses and surrenders is equal to 66.9% of the cumulative face amount of certificates, \$1,100,708,000, sold during the period.¹⁴⁶ Since certificates sold during the year 1929 show a percentage for lapses and surrenders ¹⁴⁷ of 73.5%, the percentage for the period, 66.9%, is a minimum for lapses and surrenders.

A further confirmation of the very low ratios of maturities to certificates sold and the very high ratio of lapses and surrenders to certificates sold is found in a tabulation of applicable data in Appendix G. This tabulation shows relative cumulative exit percentages for the 10 years ended December 31, 1936. Of the total exits (lapses, surrenders, and maturities) on a face-amount basis, the percentage of maturities ranged from a low of 4.88% in 1928 to a high of 6.55%

¹⁴⁴ Ibid.

¹⁴⁵ See Appendix G, p. 149.

¹⁴⁶ Including the amount of certificates outstanding and in force at the beginning of the period.

¹⁴⁷ See Appendix E, p. 146.

in 1936. The ratio of lapses and surrenders, on the other hand, ranged from a high of 95.12% in 1928 to a low of 93.45% in 1936. It should be understood, however, that, inasmuch as certificates sold during the period had maturity terms of 10 and 15 years, and that sales were on a continuing ascending scale, consequently the ratio of maturities was relatively low in comparison with lapses, which occur in the first certificate year or first 18 months for some certificates, and were low as compared with surrenders, which occur at any time between the time when the certificate attains a cash surrender value and maturity date. All maturities of the period were of certificates in force at the beginning of the period, while lapses and surrenders were of both such in force certificates and certificates sold during the period. The latter class, of course, were not old enough to have reached maturity during the period.

D. Delinquencies in Payments on Certificates

Certificates are in a state of varying delinquency as to installment payments, both as to amounts and periods, as indicated by Appendix D.¹⁴⁸ After the expiration of an arbitrarily chosen period of grace of four and one-half months after the last payment, the results as to average matured past-due payments, as of December 31, 1935, are as follows:

Year	Estimated past-due payments		Estimated average past-due period
	Amount	Percent ^a	
1929.....	\$233,977	67.0	4 years 2 months.
1930.....	122,538	60.5	3 years 4 months.
1931.....	53,613	40.7	2 years 10 months.
1932.....	27,012	29.4	1 year.
1933.....	1,020	2.2	18 days.
1934.....	10,404	16.0	About 3 months.

^a Percent of total installments paid or contemplated to be due and payable (but unpaid) according to term period of existence of certificate.

E. Losses on Surrendered Certificates for Early Years

Since the amount of certificates sold was generally at an increased rate from year to year, a proportionately increasing amount of the payments by certificate holders was absorbed by the Corporation for its own account as initial installment payments; i. e., payments for the first and second years of the life of the certificates. Table 17 illustrates the absorption, as income, by the Corporation of initial payments, and compares the experience of the certificate holder of

¹⁴⁸ Based on data taken from the reply to the Commission's questionnaire for Investors Syndicate, Table 25. See discussion in this section, *supra*.

a Series F for the first fifteen years with the experience of a depositor in a savings bank:¹⁴⁹

TABLE 17.—Comparative experience over a period of 15 years of a certificate holder of Investors Syndicate and a depositor in a savings bank

Period	Cumulative payments by certificate holder (\$120 per annum)	Surrender value at year-end	Cumulative payments over surrender value		Cumulative amount savings deposit, interest at 3 percent compounded semiannually		
			Amount	Percent	Total	Comparative advantage of savings bank over certificates	
						Amount	Percent
1 year.....	\$120	\$44	\$76	63	\$124	\$80	181.8
2 years.....	240	134	106	44	251	117	87.3
3 years.....	360	264	96	27	383	119	45.1
4 years.....	480	400	80	17	517	117	29.2
5 years.....	600	540	60	10	657	117	21.7
6 years.....	720	700	20	3	800	100	14.3
7 years.....	840	860	(20)	(2)	948	88	10.2
8 years.....	960	1,024	(64)	(7)	1,100	76	7.4
9 years.....	1,080	1,200	(120)	(11)	1,257	57	4.8
10 years.....	1,200	1,418	(218)	(18)	1,418		
15 years.....	1,800	2,500	(700)	(39)	2,303	(197)	(7.9)

The illustration represents the Series F, 15-year maturity, installment investment certificate of a maturity amount of \$2,500. As the table shows, any surrender of such a certificate within the first six years of its issuance results in a capital loss to its holder. Furthermore, after payments have been made for a full seven years in an amount of \$840, the cash surrender value of \$860 represents an increment of only \$20 over the holder's actual payments. This illustration assumes installment payments are paid annually in advance.

It is apparent from this table that an individual who deposited his funds in the savings bank instead of purchasing an installment certificate would have an investment advantage over the certificate holder at any time during the first nine years. This advantage ranged from 181.8% in the first year to 4.8% in the ninth year. It is only in the tenth year that the certificate holder is in an investment position equal to the depositor in a savings bank, but for years 11 to 15 the advantage is in the investment in the certificate. Stated otherwise, it is only after the certificate holder has made regular installment payments for more than ten years that he has any investment advantage over the depositor in the savings bank. With respect to the comparative experience of all certificate holders as a group (since, as has been indicated, substantial losses have been sustained by the investors upon

¹⁴⁹ The figures in this table with respect to the Corporation's certificates are based on the reply to the Commission's questionnaire for Investors Syndicate, Table 18.

their certificates by virtue of the fact that certificates have been lapsed or surrendered at a time when the certificates either have no surrender value or the surrender value is less than the amount paid on such certificates), it is clear that all the certificate holders as a group would have fared much better investment-wise had they deposited their funds in savings banks instead of purchasing the installment certificates.

Of significance is the fact that to the tenth year the maximum possible yield in installment payments averages 3% compounded semi-annually, while for the following five years—eleventh to fifteenth—the increment is at a rate of 5% compounded annually. The maximum possible yield of the certificate is 4% compounded annually on all installments. One percent of the rate is lost to the investor during the first ten years, but recovered in the next five years to maturity. The facts present an unusual situation, in that the yield upon the certificate holders' installment payments for the first ten years amounts to 3% and for the succeeding five years is at an average rate of 5%, or an increase in rate of 66 $\frac{2}{3}$ %.

Upwards of 90% of certificate installments are paid on less than an annual basis—principally a monthly basis. For Series F certificates, the annual installment rate is \$120, while the monthly rate is \$10.50, with a total of \$126 for the year. A comparison of annual cash surrender values with savings bank deposits of \$10.50 monthly, or \$126 per annum, shows that the advantage of such deposits increase considerably, particularly percentage-wise, over the comparison based on deposits of \$120 per annum. The annual cash surrender values and the comparative amounts and percentages of advantage (excess) are as follows:

Year	Certificate year-end cash surren- der values	Amounts and percentages of advantage (excess) of savings bank deposits, interest at 3%, com- pounded semiannually, over cash surrender values			
		Basis of annual deposit of \$120		Basis of annual deposit of \$126	
		Amount	Percent	Amount	Percent
First.....	\$44	\$80	181.8	\$83	188.6
Second.....	134	117	87.3	124	92.5
Third.....	264	110	45.1	129	48.9
Fourth.....	400	117	29.2	132	33.0
Fifth.....	540	117	21.7	135	25.0
Sixth.....	700	100	14.3	122	17.4
Seventh.....	860	88	10.2	113	13.1
Eighth.....	1,024	76	7.4	106	10.3
Ninth.....	1,200	57	4.8	91	7.6
Tenth.....	1,418	0	0.0	61	4.3
Fifteenth.....	2,500	(197)	(7.9)	(100)	(4.0)

Table 18 is a comparison of the cash values of the 15-year installment certificate, being issued by the Corporation since 1932, with a maximum possible yield equivalent to 4% compounded annually to maturity, with United States Savings Bonds, carrying an interest rate of 2.9% compounded semiannually, on the basis of an investment of \$100 per year:

TABLE 18.—Comparison of cash value of Series F certificate of Investors Syndicate and United States Savings Bonds over a period of 15 years

Year	Annual investment or installment payments (cumulative)	Comparative cumulative cash values at year-ends			Percent advantage of Savings Bonds over cumulative cash value of Investors Syndicate certificates
		United States Savings Bonds	Investors Syndicate certificates	Excess of United States Savings Bonds over Investors Syndicate certificates	
First.....	\$100.00	\$101.33	\$36.67	\$64.66	176.3
Second.....	200.00	205.33	111.67	93.66	83.9
Third.....	300.00	312.00	220.00	92.00	41.8
Fourth.....	400.00	421.33	333.33	88.00	26.4
Fifth.....	500.00	533.33	450.00	83.33	18.5
Sixth.....	600.00	648.00	583.33	64.67	11.1
Seventh.....	700.00	765.33	716.37	48.66	5.8
Eighth.....	800.00	888.00	853.33	34.67	4.1
Ninth.....	900.00	1,016.00	1,000.00	16.00	1.6
Tenth.....	1,000.00	1,149.33	1,181.67	(32.34)	(2.7)
Fifteenth.....	1,500.00	• 1,727.12	2,083.33	(356.21)	(17.1)

• Includes reinvestment of maturities after tenth year.

Similar to the comparison of the experience of the certificate holder to the depositor in the savings bank is the comparative experience of the purchaser of United States Savings Bonds. Through the first nine years the investment advantage is with the holder of the savings bonds, the advantage ranging from 176.3% in the first year to 1.6% in the ninth year. In the tenth year the purchaser of the installment certificate of Investors Syndicate has a slight advantage. This advantage increases annually thereafter, being quite substantial by the fifteenth year.

Inasmuch as the Series F certificate is generally more favorable to investors, in earlier and relatively greater cash surrender values, according to installment payments, a comparison is given of a Series A certificate of a ten-year term, sold from 1930 to 1932 (which was very much like the two immediately preceding certificates sold from 1927 to 1930), with savings bank deposits; also the greater advantage of the savings bank deposits over the Series A certificate for the first seven years of the 10-year term than over the Series F certificate, and thereafter their disadvantage. The comparison is given in Table 19.

TABLE 19.—Comparison of an investment in a Series A certificate with deposits in a savings bank (columns 2 to 8) and with like comparative percentages for a Series F certificate (columns 9 and 10)

Period	Cumulative installments payments (\$74 per annum)	Cash surrender values at year-ends	Cumulative pay- ments over cash surrender values		Cumulative amount of savings deposit, interest at 3%, compounded semiannually			Compar- ative per- centage F cer- tificates	Percent points of increase or de- crease over F certifi- cates
			Amount	Percent	Total	Comparative advantage			
						Amount	Percent		
1	2	3	4	5	6	7	8	9	10
1 year.....	\$74	\$0	\$74	-----	\$76	\$76	-----	181.8	-----
1½ years.....	111	42	69	62.2	115	73	173.8	325.0	-151.2
2 years.....	148	84	64	43.2	154	70	83.3	87.3	-4.0
3 years.....	222	166	56	25.2	235	69	41.6	45.1	-3.5
4 years.....	296	254	42	14.3	318	64	25.2	29.2	-4.0
5 years.....	370	370	0	0	404	34	9.2	21.7	-12.5
6 years.....	444	468	(24)	(5.4)	493	25	5.3	14.3	-9.0
7 years.....	518	580	(62)	(12.0)	584	4	0.7	10.2	-9.5
8 years.....	592	704	(112)	(18.9)	678	(26)	(3.7)	7.4	+11.1
9 years.....	666	830	(164)	(24.6)	775	(55)	(6.6)	4.8	+11.4
10 years.....	740	1,000	(260)	(35.1)	875	(125)	(12.5)	0	+12.5

A further comparison of the Series F investment certificates of the Corporation with like investment contracts of two life insurance companies is reflected in the following table:

Year	Attained cash surrender values			
	Cumulative annual investment	Investment certificate of corporation	Annuity of Travelers Insurance Co. ^a	Annuity of New York Life Insurance Co. ^b
First.....	\$100	\$37	\$62	\$60
Second.....	200	112	156	153
Third.....	300	220	254	254
Fourth.....	400	333	355	356
Fifth.....	500	450	460	462
Sixth.....	600	583	568	578
Seventh.....	700	717	680	694
Eighth.....	800	853	796	812
Ninth.....	900	1,000	916	937
Tenth.....	1,000	1,182	1,040	1,165
Fifteenth.....	1,500	2,083	1,745	1,781

^a Travelers Insurance Co. pays cash surrender values in installments only, not in a lump sum. The figures as to this company were obtained from *Best's Rate Book*, 1936, p. 1339.

^b *Best's Rate Book*, 1936, p. 895. Amounts include 1936 dividend scale accumulations.

From the first to the fifth year the cash-surrender values for investment contracts of insurance companies exceed those of the Corporation, but thereafter the reverse is true.

Series F certificates, Article 7, Paid-up Contract, provides:

After this Contract has attained an optional settlement value, it may be converted into a Paid-Up Contract in an amount equal to the then cash value of this

Contract as provided in Article 12 plus interest at 4% per annum for ten years, compounded annually, due ten years from the date of conversion. Such conversion shall be effected by amendment evidenced by a rider dated and signed by the Company either at the request of the second party or at the option of the Company, as provided in Article 5 (D).

Article 5 (D) provides:

In the event the second party fails to exercise any one of the above options, the Company may at any time after said two-year default convert this Contract into a Paid-Up Contract as provided in Article 7. In the event of a continuous default for two years where no optional settlement rights have been attained under Article 12, then, except as to the right under Option 3 above to receive a new Contract or this Contract endorsed as provided in said option, with sums credited thereon, the rights of the second party shall cease and determine.

The optional values referred to are year-end or anniversary cash-surrender values. As appears, therefore, no allowance is made for installments paid for periods of less than a full twelve months.¹⁵⁰

F. Losses to Certificate Holders Through Delay in Installment Payments

If the certificate holder fails to make any installment payment as it becomes due, the Corporation suspends improvement of the certificate of such holder on the aggregate of all previous payments and accretions. Series F certificate, Article 5 (A), provides: "In the event payments are not made when due * * * nothing shall accrue on the Contract and its value shall not increase, for or during any periods of default * * *." Other series have like provisions.

This practice is very significant. For example, if a certificate holder has met his payments regularly for five full years, his certificate will have a definite and fixed cash-surrender value at the end of that period. If for the next two years no installments are paid, the cash-surrender value of the certificate at the end of the seven years is identical with that at the end of the fifth year. (In the case of a deposit in a savings bank, of course, the amount on deposit continues to be credited with interest so long as it remains on deposit.) In the illustrative case and all similar cases the Corporation has the use of the funds of the certificate holder without cost.

The extent of the possible gain to the Corporation and loss to the certificate holder may be illustrated by a hypothetical case. Assume two individuals are each the holder of a 10-year installment certificate with an improvement rate equivalent to 4% compounded annually with payments to be made at \$100 per year. One certificate holder makes all his payments as required. At the end of 10 years the sum of his payments plus improvement at the agreed rate will amount to \$1,249, of which \$1,000 represents capital contribution and \$249 the increment thereto. The other certificate holder makes his payments only in every other year and thus requires 20 years to complete his payments. At the end of the 20 years the sum of his payments plus improvement at agreed rate will amount to \$1,548, of which \$1,000 is his capital contribution and \$548 is represented by improvement

¹⁵⁰ Losses of this character are discussed *infra*, p. 68.

at the stipulated rate. Since both holders would be entitled to the same sum of \$1,249 at the completion of their respective payments, the Corporation would realize a benefit of \$300, represented by the excess interest earning, more from the delinquent holder than from the holder making the payments on time.

There are no data available from which the amount of such suspended improvement to certificates in any fiscal period may be determined. That the amount is large is obvious in view of the fact that many certificates are in various stages of delinquency at some time during their life.

The following table shows the status of certificates, on the basis of maturity amounts, in force in the State of Missouri at September 11, 1937:

Status	Maturity amount	Percent of total
Current.....	\$11, 136, 700	61
1 to 2 months delinquent.....	1, 428, 050	8
3 to 6 months delinquent.....	1, 410, 450	8
7 to 12 months delinquent.....	1, 495, 150	8
13 to 24 months delinquent.....	2, 395, 700	13
24 to 30 months delinquent.....	406, 350	2
Total.....	18, 272, 400	100

Since a current certificate is often one upon which a monthly installment has been currently paid, although it might have been 10 months or more in arrears before such payment, there are included as current certificates a relatively substantial amount of certificates which may have been either occasionally or chronically delinquent.

Because of the significance of this practice of penalizing certificate holders by a suspension of reserve improvement, an analysis has been prepared which shows on an estimated basis the extent to which funds of certificate holders (reserves against certificate obligations) earned interest, or other income during periods of delinquency in installment payments, from which such certificate holders received no benefit. This analysis will be found in Appendix L. The amounts of such estimated losses by certificate holders and gains to the corporation were, by years, as follows: 1929, \$350,000; 1930, \$739,000; 1931, \$979,000; 1932, \$974,000; 1933, \$1,200,000; 1934, \$596,000; 1935, \$387,000; and 1936, \$539,000. The total for the 8-year period was \$5,764,000. In making the computations, the amounts shown include the effect of heavy arbitrary deductions from estimated installments due and payable to compensate for alleged higher delinquency against certificates in force for the shorter periods than for the longer periods of time, the relative rates of improvement being less for shorter than for longer periods, and the fact that until cash surrender values are attained installment payments are subject to no improvement. Without giving effect to such deductions, the estimated losses for the period total \$8,381,000 instead of \$5,764,000.¹⁵¹

¹⁵¹ See Appendix L, note c, p. 155.

¹⁵² Public Examination, Investors Syndicate, at 21560-61.

These amounts are 31.9% and 21.5%, respectively, of total gross income for the period 1927-1936 from all sources except initial payment receipts. The amount, \$5,764,000 is more than three times the total net profit of \$1,745,000 for the same period, which signifies the importance to the Corporation of this practice of suspending the improvement process during periods of certificate holders delinquency.

G. Limitations on Payments on Surrendered Certificates

The previous discussion on surrender values was predicated on the assumption that the certificate holder made all the required payments on time each month during the year. Stated otherwise, it was assumed that the holder made the required payments up to the anniversary date, the end of the year. The anniversary date means the date upon which surrender value actually accrues or increases on the certificate. However, in reality there are significant and material limitations upon the certificate holders' right to surrender values. Payments to certificate holders who surrender their certificates for cash are restricted to the cash surrender value at the last attained anniversary.

Mr. Crabb testified:¹⁵²

"Q. Now, if a certificate holder has one of these contracts on an installment basis, monthly installment basis, and drops out any time before the twelfth installment, does he get anything back?

A. No; he gets nothing; there is no cash value in the first year.

Q. Until after the twelfth monthly installment?

A. That is correct.

Q. Now, let us assume this case. Suppose that a man has paid 20 installments, monthly installments. That is almost 2 years. And then he surrenders his contract. What would the cash surrender value be?

A. Well, strictly speaking, his cash surrender value would be the amount payable at the end of the first year.

Q. In other words, on your \$120 per annum it would be \$44.00?

A. Yes."

The effect of denying to the holder any surrender value or accretion of surrender value, except on the anniversary date of the certificate may be illustrated by a few simple examples. Assume the case of a certificate with face amount of \$2,500, with monthly installment payments of \$10.50, a purchaser who paid all the 12 monthly installments during the first year, totaling \$126, would have a surrender value of \$44 at the end of the first year. If the purchaser made 11 consecutive monthly payments the first year, or a total of \$115.50, and then ceased making payments, his certificate would have no surrender value at all. If the purchaser paid six monthly installments the first year, a total of \$63, and then desired to obtain any surrender value on his certificate, he would have to pay six more monthly installments, or an additional \$63.50, to reach the first anniversary date, and then he would only receive \$44 in surrender value. If it be assumed that the purchaser made the first year's payments in full (when his surrender value would be only \$44) and then continued to make 11 monthly payments for an additional total of \$115.50, or aggregate payments of \$241.50, and then ceased payments, the surrender value of his certificate would still be only \$44. However, if he made the 24th monthly payment, or an aggregate of \$252, his surrender value would be \$134.

The Corporation defended this practice of surrender values only as of anniversary dates upon the following grounds: ¹⁵³

Regarding the question of the rights of a contract holder who has paid some part of the annual payment beyond a surrender value. The protection afforded in such cases is covered by Article 5 (B), which reads as follows:

"In the event the second party shall reinstate this Contract after default by resuming payments and shall thereafter make up such defaulted payments and apply for the optional settlement value, he shall be entitled to receive the then present worth of such optional settlement value under Article 12, for the time paid for, computed at 6% per annum for the period from the date such optional settlement value is paid to the extended due date of the optional settlement applied for."

The management of Investors Syndicate feels that it is quite important from the standpoint of safety to limit surrender values to annual rests, otherwise the hazard of wholesale withdrawal demands amounting to a run would be greatly increased. The very nature of the business requires, and one of its fundamental principles is that the company avoid so far as possible the functions of a bank. Any withdrawal values are in the nature of a privilege. Values of this nature find justification in the experience of insurance companies over a period of many years and have statutory recognition in the various states, but they are something of a departure from strict investment principles. The management feels it is most important that such privileges be kept strictly within bounds.

To illustrate more clearly the rights of a contract holder, the following example is cited: Contract holder "A," owning one unit, has paid his contract for a period of 4 years and 3 months, and the contract has been in force more than 4 years. He desires to cancel his contract and withdraw his surrender value. Two courses are open to him, under either of which he protects his additional 3 months' payments.

(1) He may borrow the 4-year value, applying part of the proceeds thereof to complete the payments for the fifth year, in which event the net sum paid to him would be as follows:

Loan	\$400. 00
Less:	
Interest at 6% for 9 months.....	\$18. 00
Payments for 9 months.....	92. 00
	<u>110. 00</u>
Net amount available.....	290. 00

Nine months thereafter he would be entitled to the fifth-year value of \$540.00 and would receive an additional check for \$140.00 without deduction.

In the example cited, this would be the most favorable settlement. In some cases where we felt conditions warranted, we have made a practice of allowing the contract holder to exercise the fifth-year value upon a discount basis. In that event, we would allow him the full \$540 less the discount at 6% for 9 months, and less the remaining 9 months' payments.

(2) In the event the full 5 years should have expired at the time the contract holder desires to cancel his contract, then under the clause quoted the subscriber would have the right to demand the full fifth-year value on a present worth basis. In that event, the calculation would be as follows:

Fifth-year value.....	\$540. 00
Present worth at 6%.....	516. 75
Less 9 months' payments.....	92. 00
	<u>424. 75</u>
Net amount available.....	424. 75

In the particular instance cited, this settlement would be slightly less favorable than the one available as previously described. This form of settlement is of greater use where there has been an accumulation of short defaults or where the period paid for more nearly approaches the next anniversary. For example, if the subscriber had paid 4 years 11 months, the present worth would mean a discount of only approximately \$2.70.

¹⁵³ Derived from supplementary information supplied the Commission for Investors Syndicate.

In the first illustration given by the Corporation, the certificate holder may receive currently \$290, consisting of the fourth year's attained surrender value of \$400, plus the fifth year's installments actually paid of \$30 (total \$430), less \$140, payment of which is deferred until the fifth anniversary. In other words, the holder would have paid \$510, and would receive immediately \$290 and \$140 at the end of the year, or a total of \$430, sustaining a loss of \$80. Furthermore, the holder does not receive any improvement of the cash surrender value of his certificate as at the end of the fourth year or on the fifth year's installment payments. If it were essential for the holder in the illustrative case that he receive immediately the maximum proceeds available to him, then he would get the fourth year's surrender value of \$400, and thus forfeit not only the entire \$30 representing his payments during the fifth year, but, in addition, of course, the difference between the surrender value and the amount actually paid by the holder, \$80, or a total loss of \$110 on \$480 paid in (23%).

In the second illustration given by the Corporation the certificate holder receives immediately an amount only \$5.25 less than the total of \$430, or \$424.75, provided five full years have elapsed since the issuance of the certificate—the next full anniversary date is reached. Under this illustration the holder would have paid \$510 on his certificate and would receive if he waited until the end of the fifth year \$424.75, or sustained a loss of \$85.25. Otherwise, if he needed the maximum proceeds of his certificate immediately, and the certificate has been outstanding for more than four but less than five years, he would be paid the cash surrender value at the end of the fourth year, \$400, and therefore lose not only his three months' payments for the fifth year in the amount of \$30, but, as has been indicated, the difference between his amount paid in and the surrender value, or an additional \$80.

H. Certificate Loans to Certificate Holders

The Corporation charges interest on loans to certificate holders on a discount basis—the amount actually turned over to the holders is the amount of the loan less the first six months' interest. Upon loans repaid before maturity, unearned interest is refunded. The following table compares the effective rate of interest return on the regular basis with the discount basis for loans made for periods of six months and renewed for like periods:

	Comparison of effective annual return on—		
	Rate	Regular basis	Discount basis
	<i>Percent</i>	<i>Percent</i>	<i>Percent</i>
Loans for less than \$300.....	7	7.12	7.33
Loans for \$300 to \$500.....	6½	6.61	6.83
Loans from \$500 to \$1,500.....	6	6.09	6.23
Loans over \$1,500.....	5½	5.58	5.74

Another comparison may be made. A depositor in a savings bank may withdraw his funds and use them free from any interest burden.

His interest increment is simply reduced to the extent and for the period that his principal is withdrawn from the account.¹⁵⁴ In the case of certificate holders of the Corporation, however, the interest charged on certificate loans increases the cost to the holders for the maintenance of their certificates, and often so operates as to reduce the realized surrender values to the holders. For example, assume that a certificate has a loan or surrender value of \$1,000, and the holder elects to or is encouraged to borrow this amount instead of surrendering his certificate for cash. He executes a six months' note for \$1,000 and actually receives from the Corporation \$1,000 less a \$30 discount, or \$970. At the end of six months the holder executes a renewal note for \$1,000 and pays \$30 interest for this period. If at the end of the second six-month period, the holder-borrower is forced by circumstances to surrender the certificate, the holder has received a net amount against his certificate of \$940, and the Corporation has gained the difference of \$60 between that amount and \$1,000 which was the surrender value at the beginning of the period. In other words, the holder has paid \$60 for the privilege of keeping his contract active with the Corporation for one year. A depositor in a savings bank could have withdrawn without this penalty. Such situations cause considerable comparative loss to certificate holders,¹⁵⁵ and the longer the loan is continued the greater the loss to the certificate holder and gain to the Corporation.

The following table¹⁵⁶ gives the certificate loans for the period January 1, 1927–December 31, 1936, together, with breakdown of repayments by cash payments and by surrender of certificates:

Certificate loans at Jan. 1, 1927-----	\$757, 096
Certificate loans from Jan. 1, 1927, to Dec. 31, 1936-----	^a 16, 139, 424
Total-----	16, 896, 520
Cash amount repaid on certificate loans from Jan. 1, 1927, to Dec. 31, 1936 (26.8% of total repayments) --	^a \$3, 476, 020
Settlement of certificate loans through surrender (before or at maturity) of certificates from Jan. 1, 1927, to Dec. 31, 1936 (73.2% of total repayments) --	^a 9, 489, 402
	12, 965, 422
Certificate loans outstanding at Dec. 31, 1936-----	^b 3, 931, 098

^a Includes relatively small disbursements, repayments, and surrender settlements (amounts net shown separately) for loans on certificates of Investors Syndicate Title & Guaranty Co. Of \$9,489,402, the sum of \$3,366,000 considered as applicable to matured certificates, and the balance, \$6,123,402 to surrendered certificates.

^b Includes \$129,893 of loans on certificates of Investors Syndicate Title & Guaranty Co.

As the above table indicates, repayments of certificate loans by holders were 26.8% in cash and 73.2% through surrender of certificates, matured and unmatured. The 73.2% of loans settled by sur-

¹⁵⁴ There would be some relatively negligible interest sacrifice if withdrawals were made between semiannual or other interest computation periods.

¹⁵⁵ Public Examination, Investors Syndicate, at 21558–61.

¹⁵⁶ This table is a summary of Appendix F, p. 148, which shows the amount of certificate loans outstanding at the end of each year from 1927–1936, and the interest earnings of the Corporation on such loans for such years, together with annual disbursement, repayments, and settlements by surrender of certificates.

render of certificates is equivalent to 56.2% of all loans, both repaid (by cash or surrender either before or at maturity, 76.7%) and outstanding (23.3%). The figure representing the repayments of loans by surrender of certificates is significant. Holders desiring to surrender their certificates and obtain their surrender values may have been encouraged to take the loan values of these certificates (which were equal to surrender values at the time) in the hope by the Corporation that the holders would ultimately repay the loans in cash and then continue to make payments. However, it is indicated that approximately three-fourths of these loans on certificates were not repaid by cash but by the surrender of the certificates, either at or before certificate maturity. The only effect of these transactions was therefore that the holder ultimately terminated his contract and received, not his full surrender value, but his surrender value less the interest paid to the Corporation on the loan.

Interest on these loans received by the Corporation for the 10-year period, 1927-1936, amounted to \$2,015,630. It may therefore be inferred that surrendered certificate holders who paid their certificate loans by surrender of their certificates lost 36.2%¹⁵⁷ of \$2,015,630, or \$729,658. This conclusion is based upon the assumptions that borrowing certificate holders, who surrendered their certificates before maturity, ordinarily discontinue their installment payments,¹⁵⁸ and therefore their certificates receive no further interest accretions, and that the final surrender value of the certificates surrendered in discharge of the loan is identical, for practical purposes, with the value at the time the loan was made.

The ratio at year-ends of loans on certificates to the total amount of certificate surrender value and other reserve obligations¹⁵⁹ varied from a low of 4.38% in 1928 to a high of 8.47% in 1932. For 1936 the percentage was 4.70%. Depression years show the highest percentages.¹⁶⁰

The settlement of certificate loans by the surrender of matured certificates was a relatively small proportion of total maturities for the period 1927-1936, amounting to about 10.8% of certificates matured. Total maturities for the same period amounted to \$31,111,000, of which \$27,745,000 represented current cash disbursements, leaving a balance of \$3,366,000 affected by loans settled by the surrender of matured certificates.

The proportion of unmatured certificates surrendered in settlement of loans is much greater. For the period the total amount of unmatured surrendered certificates, on a cash surrendered basis, was \$26,607,000 exclusive of \$2,354,000 of certificates called and paid in cash. The \$26,607,000 was settled by payment in cash of \$18,632,000 and surrender of certificates of \$7,975,000, or 30% of the total.¹⁶¹

¹⁵⁷ Ratio \$9,489,402 to \$16,896,520.

¹⁵⁸ For the reason, *inter alia*, that the interest accumulations on installment payments would be less than that on the loans.

¹⁵⁹ Including certificate reserves.

¹⁶⁰ In those years the percentages were: 1930, 5.92%; 1931, 7.02%; 1932, 8.47%; 1933, 8.06%; and 1934, 5.91%.

¹⁶¹ The figures shown in Appendix F, p. 148, relating to certificate loan settlements, were constructed as balancing amounts. The total of \$9,490,000 shown by the analysis is \$1,852,000 less than the two amounts mentioned above, viz: \$3,366,000 for total maturities for the period and \$7,975,000 for total surrenders prior to maturity. The difference is not explained by available data.

I. Cost to Certificate Holders on Installments Paid on Semi-annual, Quarterly, and Monthly Bases

The certificates make provision for varying discounts, in essence, in the amount to be paid if the holders pay the full year's amount in advance, or on a semiannual or quarterly basis. A holder paying a full year's payment in advance pays less than on a semiannual basis, and a holder paying on a semiannual basis pays less than on a quarterly basis, etc. For the certificate issued at the end of 1936,¹⁶² the comparative total annual payments according to bases used were as follows: annual, \$120; semiannual, \$122.00; quarterly, \$124.00; monthly, \$126.00. Assuming an average annual yield of 5% for the period 1927-36, monthly installment payments, \$10 plus 50 cents for installment added or \$10.50 per month or \$126 per year, have a return value to the Corporation for the year of \$9.41 (5% on 12 months' installments of \$10.50) which is the equivalent of 7.84%, compared with a return of \$6 (5% of \$120) on payment of a full year's installments in advance. The Corporation treats the amounts in excess of the sums due on the annual basis as income and not as installment payments. These amounts are carried on the books of the Corporation as "collection revenue." In the aggregate, this item is large and first appeared as "collection revenue" in the income accounts of the Corporation in 1931.¹⁶³ From 1931 to 1936, this revenue totaled \$2,348,978. For 1936, the total was \$1,023,157, and was equivalent to 20.1% of the gross revenue of the Corporation for that year, exclusive of initial payment receipts in the amount of \$3,752,891. Total payments by certificate holders in 1936 were about \$24,000,000. Estimating monthly installment payments at 75% of total payments by certificate holders, the total installment payments for the year were \$18,000,000. The monthly load imposed by virtue of payment in monthly installments at 5% equals \$900,000 contrasted with \$487,500 actual interest earnings required to compensate at 5% for payments on a deferred monthly basis. So estimated the Corporation realized a gain from this source of about \$412,500.

J. Costs Per \$1 Paid to and Retained for Certificate Holders for 10-Year Period 1927-1936

The following table shows the costs of the Corporation in terms of total payments by certificate holders to the Corporation and by the Corporation to certificate holders:

Surrender value and other reserves of certificates at Jan. 1, 1927,	
and subsequent payments by certificate holders to Dec. 31, 1936--	\$148, 908, 000
Gross income from Jan. 1, 1927, to Dec. 31, 1936 (excluding initial	
payment receipts of \$25,547,000 for 1929 to 1936)-----	" 27, 155, 000
<hr/>	
Total surrender value and other certificate reserves at	
Jan. 1, 1927, subsequent payments by certificate holders	
to Dec. 31, 1936, and gross income receipts as qualified,	
1927-1936-----	176, 063, 000

¹⁶² Certificates of 15-year maturity and \$2,500 maturity amount.

¹⁶³ It is emphasized that these data, like most of the other material in this report, are based on material submitted by the Corporation. No field study was made.

Distribution to and retained value for certificate holders:

Amount distributed to certificate holders-----	\$60, 116, 000	
Contract liabilities and reserves applicable to certificates in force Dec. 31, 1936-----	83, 571, 000	
		<u>143, 688, 000</u>
Balance, or excess of surrender value and other certificate reserves, at Jan. 1, 1927, and subsequent payments by certificate holders to Dec. 31, 1936, and income as above indicated, over amounts of distribution to and values retained for certificate holders-----		32, 375, 000
Deduct: Net profit, as stated, for period-----		2, 052, 000
		<u>30, 323, 000</u>
Percentage cost for each \$1 of amount of payments to and values retained for certificate holders-----		21. 2%

^a Excludes collection revenue of \$2,349,000 included in payments by certificate holders.

K. Net Asset Margin of Safety Applicable to Contract Liabilities and Reserves for Outstanding Certificates

Data pertaining to the margin of safety of net assets over the total cash surrender value of certificates for the period from 1927 to 1936 and constructions thereof will be found in Appendix B.

The margin of net assets (determined without deduction of certificate obligations) over the cash surrender value of outstanding certificates (including other liabilities and reserves) appears to be narrow. In terms of percentages the margin of safety ranges from a high in 1927 of 5.3% to a low in 1934 of 2.4%. By years these percentages of margin of net assets are as follows:

	Percent		Percent
1927-----	5. 3	1932-----	3. 0
1928-----	4. 5	1933-----	3. 4
1929-----	4. 0	1934-----	2. 4
1930-----	3. 6	1935-----	2. 5
1931-----	3. 4	1936-----	2. 5

These margins must be considered in the light of two important factors: (1) that a large part of the liabilities of the Corporation are in the nature of demand liabilities, that is, the certificate holders can at any time demand the surrender value of their certificates plus any advance payments; and (2) that a large part of the assets of the Corporation consists of mortgages, which are slow liquidating assets.

Most of the certificates outstanding provide for the maintenance of assets of a certain specified character equal to \$110 for each \$100 of certificate liability. As previously noted the Corporation has taken the position that these covenants do not require the earmarking or pledging of specific assets, but instead constitute merely an investment yardstick. This treatment appears to be confirmed by the fact that if book liabilities (excluding net worth) are increased by sums equal to the additional guaranty coverage of 10% for certificates so affected, asset deficiencies for four years for which data are available would have been: 1933, \$1,957,684; 1934, \$2,309,937; 1935, \$2,804,898; and 1936, \$3,488,971.

CHAPTER III

FIDELITY INVESTMENT ASSOCIATION

I. ORGANIZATION, DESCRIPTION, AND HISTORY

A. Incorporation and Description

Fidelity Investment Association, hereinafter referred to as the Association, is engaged in essentially the same business as Investors Syndicate—the sale of face amount installment investment certificates and the investment of funds received from such sales.

The Association was incorporated as Fidelity Investment Loan Association on April 26, 1911, under the laws of West Virginia, for a period of 50 years. On December 7, 1912, the Association amended its corporate name to its present designation.¹ The principal office of the Association has always been in Wheeling, West Virginia.²

The capital stock of the Association consists of preferred stock and common stock. Control is in the common stock which is more or less closely held. The securities which are continuously sold to the public are not the capital stock of the Association but the face amount installment investment certificates issued by the Association.³ These certificates vary as to terms and maturity.

B. Total Assets

The Association invests its funds in United States Government and municipal bonds; bonds, notes, and debentures of railroads, public utilities, industrial and financial corporations, foreign governments and corporations; real estate bonds; and in preferred and common stocks generally.⁴

At December 31, 1936, the classified assets⁵ of the Association and subsidiaries, on the basis of book values, were as follows:

Cash	\$1, 000, 000
Investments in securities:	
Bonds, notes, etc.	\$23, 000, 000
Preferred and common stocks	2, 800, 000
	25, 800, 000
Certificate and other loans	3, 200, 000
Real estate	250, 000
Interest receivable	550, 000

¹ Public Examination, Fidelity Investment Association, at 21603. Reply to the Commission's questionnaire for Fidelity Investment Association, Item 2. It must be noted that the material in this chapter is, as in the case of other sections of this report, based almost entirely upon information supplied the Commission by the companies themselves, which information has not been verified independently by the Commission's staff.

² Ibid.

³ Unlike Investors Syndicate, the Association offers only one type of investment certificate—the installment type.

⁴ See *infra*, Sec. VIII, *Management of Assets*, p. 96.

⁵ In round amounts.

At December 31, 1936, the total assets of the Association were approximately \$31,000,000, on a book-value basis, of which about \$26,000,000 represented investments in portfolio securities. The cash surrender value of all certificates outstanding was \$27,100,000 against reserves of \$28,700,000—both on a consolidated basis.^{5a}

C. Subsidiaries and Employees

The Association had, at December 31, 1936 three wholly-owned subsidiaries. One subsidiary, Fidel Association of New York, Incorporated, was engaged in the sale of installment investment certificates in New York and Connecticut. The other two subsidiaries, Paull Company and Marston Corporation, were both organized in the latter part of 1936, to manage "certain types of investments requiring specialized supervision."⁶

At December 31, 1936, the Association and its subsidiaries had 850 employees, of whom 147 were employed solely on a salary basis, 696 were solely on a commission basis, and 7 employees were on a salary and commission basis. At December 31, 1935, the Association maintained 28 branch offices for the sale of the investment certificates.⁷

At December 31, 1936, the Association or its subsidiary, Fidel Association of New York, Incorporated, was authorized to sell its certificates in 18 states and the District of Columbia. The states were West Virginia, Delaware, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Michigan, Missouri, Ohio, Pennsylvania, Tennessee, Virginia, Wisconsin, New York, and Connecticut.

II. CAPITALIZATION, CONTROL, AND AFFILIATIONS

A. Capitalization

The capitalization of the Association, at December 31, 1936, consisted of 9,110 shares of Series A, \$100 par, 5% cumulative preferred stock, a total of \$911,000, and 8,123 shares of \$100 par common stock, a total of \$812,300.⁸ There were 338 common stockholders and 799 preferred stockholders at this date.⁹

The preferred stock is 5% cumulative as to dividends and is without voting rights except upon failure of the Association to pay or provide for payment of full annual cumulative dividends. Upon such an event the preferred and common stocks carry equal voting rights, share for share.¹⁰

The Association had no funded debt, but two of its wholly-owned subsidiaries, Paull Company and Marston Corporation, had collateral trust debentures outstanding in the respective amounts of \$2,145,000¹¹

^{5a} A consolidated general balance sheet of the Association is contained in Appendix M-1, p. 158.

⁶ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 4. For a discussion of these subsidiaries see *infra*, Sec. II, *Capitalization, Control and Affiliations*, p. 76.

⁷ Reply to the Commission's questionnaire for Fidelity Investment Association, Items 4 and 8.

⁸ Reply to the Commission's questionnaire for Fidelity Investment Association, Items 14 and 15. See also Public Examination, Fidelity Investment Association, at 21665.

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ Including \$39,000 to be issued.

and \$2,270,000.¹² These debentures are held by the Association and are collaterally secured by certain assets transferred to the subsidiaries by the parent. The alleged purpose of the transfer was to give to the assets so transferred expert management.¹³

B. Stock Ownership

The Association is, in the absence of a passage of dividend upon the preferred stock, controlled by the holders of its common stock in whom are vested all voting rights.¹⁴ At December 31, 1935, there were a total of 338 holders of the common stock, owning a total of 8,123 shares, each share having a par value of \$100. Of this total, 3,198¹¹/₁₅ shares, or about 40% of the shares outstanding, were owned by officers and directors. The distribution of this block owned by the management was as follows:

Name	Position	Number of shares of common stock	Percent of total shares
C. H. Copp.....	Director.....	540	6.6
W. T. Grossoup.....	do.....	318 ⁷ / ₁₀	3.9
L. B. Hanna.....	do.....	75	.9
A. L. King.....	Director and assistant treasurer.....	704	8.7
John Marshall.....	Director and chairman of board.....	750	9.2
F. S. Risley.....	Director, vice president, and secretary.....	355	4.4
H. Sutherland.....	Director.....	280	3.5
C. A. Thompson.....	Director and president.....	75	.9
Miscellaneous.....	Directors (2).....	7	.1
	Directors and officers (3).....	46 ¹ / ₂	.6
	Officers (7).....	478 ¹ / ₅	.6
Total.....		3,198 ¹¹ / ₁₅	39.4

C. Subsidiaries

At December 31, 1936, the Association had three wholly-owned subsidiaries—Fidel Association of New York, Incorporated, Paull Company, and Marston Corporation.

1. FIDEL ASSOCIATION OF NEW YORK, INCORPORATED

Fidel Association of New York, Incorporated, was incorporated under the general corporation laws of New York¹⁵ on November 6, 1931, for the purpose of carrying on the sale of face amount installment certificates in the State of New York.¹⁶ This subsidiary also sells its certificates in the State of Connecticut, to the exclusion of the certificates of its parent. At December 31, 1936, this company had

¹² Including \$214,000 to be issued.

¹³ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 4. See also Public Examination, Fidelity Investment Association, at 21062.

¹⁴ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 2.

¹⁵ L. 1909 c. 23 and c. 59; S. C. L. Sec. 2, as amended.

¹⁶ Public Examination, Fidelity Investment Association, at 21602-3.

outstanding 1,000 shares of \$100 par common stock, all owned by the Association.¹⁷

The investment certificates which this subsidiary sells are undivided interests in specific collateral deposited with a trustee.¹⁸

2. PAULL COMPANY AND MARSTON CORPORATION

These two subsidiaries were incorporated under the laws of West Virginia on July 20, 1936, as "general corporations specializing in investment management powers."¹⁹ The principal purpose of their organization was stated to be "investment in real estate securities."²⁰ At December 31, 1936, the Association had transferred to the companies certain of its assets and received in exchange therefor collateral trust bonds of the subsidiaries secured by the transferred assets.²¹ Each company had an outstanding capital stock of \$5,000.²²

III. TYPES OF CERTIFICATES SOLD

The investment contracts or certificates issued and sold by the Association are in essence agreements between the association and the investor, whereby in consideration of a certain number of agreed periodic payments by the holder to the Association, the Association agrees to pay to the holder, upon the expiration of a certain period, a specified sum of money, either in installments or in a lump sum.²³ The contracts ordinarily provide for the payment by the Association to the holder of the maturity amount in installments with the right of the holder to elect to receive payment in a lump sum.

A. Amount of Certificates Outstanding

Investment certificates of the Association, issued and outstanding at December 31, 1936, had ²⁴ a maturity amount of \$247,062,000 and a reserve or surrender value of \$27,110,000, or 11% of the maturity value.²⁵ The number of certificates outstanding at this date was 96,245, with an average maturity amount of \$2,567 and an average surrender value of \$282.

¹⁷ Reply to the Commission's questionnaire for Fidel Association of New York, Incorporated, Items 14 and 15; see also Public Examination, Fidelity Investment Association, at 21062-3.

¹⁸ A balance sheet of this company may be found in Appendix M-2, p. 160.

¹⁹ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 4; see also Public Examination, Fidelity Investment Association, at 21062-3.

²⁰ Ibid.

²¹ For more detailed discussion of the reasons for the creation of these 2 companies and of the assets transferred see *infra*, Sec. VIII, *Management of Assets*, p. 96.

²² Ibid; balance sheets of these companies will be found in Appendixes M-2 and M-3, pp. 160-2.

²³ The certificates issued by the Association are essentially the same in nature as the certificates issued by Investors Syndicate.

²⁴ On a consolidated basis.

²⁵ Derived from supplementary information supplied the Commission by Fidelity Investment Association.

B. Nature and Conditions of Certificates

The certificates sold by Fidelity Investment Association are all of the installment payment type, providing for monthly payments for a definite number of months, usually 120 months.²⁶ Certificates are issued either with or without insurance provisions. The monthly installment payments are the same for certificates with insurance as for the certificates without insurance, but the cash surrender values in the former type are slightly less than in the latter. The insurance is carried by the Association with a regular legal reserve insurance company.

The purpose of the insurance provision is to insure the parties against a lapse or other termination of the contract should the certificate holder die before completing all his installment payments. By the terms of the provision, the Association is insured in an amount which, together with existing reserves, is sufficient upon the death of the holder for the Association to declare the contract fully paid, so that upon maturity the estate of the deceased holder will receive the maturity amount of the certificate. In other words, the balance of the payment due on the certificate at the time of death of the holder is insured.

The surrender value of the certificate, which is slightly less than the value for the same series of certificates without insurance, is available upon the death of the certificate holder.

All the certificates issued by Fidelity Investment Association attain monthly cash surrender values and loan values.²⁷ It will be recalled that the certificates issued by Investors Syndicate attain only annual cash surrender values and loan values. The loan values vary from 90% to 100% of cash surrender values with different certificates issued by the Association, according to the series involved. Certificates sold since 1925 have varied as to the time at which the certificates first attain any cash surrender values, the periods varying from 10 months to 16 months after issuance.

At December 31, 1936 the Association had 10 types of certificates or contracts outstanding. Four of these types or series were companions to four of the remainder. In other words, contracts of this companion class represented conversions from other classes and were fully paid, but they had at the time of their issuance deferred maturity dates. The types of certificates in force are shown in Table 19-A.

²⁶ It will be recalled that Investors Syndicate issues three types of certificates: installment payment certificates, coupon certificates, and single payment certificates.

²⁷ One series of certificates which was discontinued in 1925 did not have surrender values.

TABLE 19-A.—*Types of certificates of Fidelity Investment Association outstanding at December 31, 1936*

Title of contract	(1)	(2)	(3) = (2) - (1)
	Number of required monthly payments (including initial payment on a monthly basis of payment)	Number of months after due date of first initial or monthly installment payment before annual maturity settlement on contracts begin	Number of months after maturity which must expire before installment to holder ^a commences
Special income contract.....	132	146	14
Paid-up contract.....	132	^b 146	14
Special annuity contract.....	132	145	13
Paid-up annuity contract.....	132	^b 145	13
Income reserve contract, A.....	142	158	16
Paid-up income reserve contract, A.....	142	^b 155	13
Income reserve contract, B.....	126	130	4
Paid-up income reserve contract, B.....	126	^b 130	4
Income reserve contract, C.....	142	155	13
Income reserve contract, D.....	120	129	9

^a The monthly installment payments by the association after maturity do not commence immediately upon maturity but a specified period of time after maturity. This column gives the number of months after maturity which the holder must wait before the installment payment by the company on account of the maturity amount commences.

^b Period according to due date of first initial or monthly installment payment of original contract.

In the case of all these certificates or contracts ²⁸ the certificate holder agrees to make a definite number of monthly installment payments, and at the termination of the maturity period prescribed the certificates have a definite and fixed value. This sum is not calculated for immediate payment by the Association, however, but for deferred payment in installments over a period of years. If the certificate holder wants his money immediately upon maturity, he may elect to do so, but he obtains a sum—the commuted cash value—equivalent to about 80% of the deferred-payment or maturity amount. The same arrangements for payment upon maturity apply to the paid-up certificates.

The settlement payments by the Association are specified amounts, payable annually in most cases (although in some cases they are payable semi-annually, etc.) for a definite period of years or for other periods. In addition, the certificates usually provide that the settlement payments are to commence at the expiration of a specified number of months after the due date of the first payment by the certificate holder (see table supra). Thus, a 10-year term installment contract may actually involve a period of 20 years before the holder receives the entire maturity amount—10 years for the holder to make his payments to the Association, then a few months before the installment payments on account of the maturity amount commence, then 10 years for the Association to settle with the holder on an installment basis.

²⁸ Except paid-up conversion contracts.

C. Provisions Relating to Lapses

As to lapses of certificates, the Association reported:²⁹

"As all Fidelity contracts have the redate privilege there are no lapsed contracts."

The "redate privilege" is a privilege given to the holder who, after making some payments, fails to meet subsequent payments, to redate the issuance of the certificate and resume payments as if no default had occurred, receiving full credit for payments already made. Upon resumption of payments, the "date of issuance" of the certificate is advanced a period of time equal to the period of time the holder was in default of payments. For example, assume that a certificate was issued on January 1, 1933; the holder made six monthly payments through June 1933; and then defaulted for three months through September 1933. If the holder desired to resume his monthly payment, date of issuance of his certificate would be redated to April 1, 1933, as of three months after the original date of issuance. The certificate holder was in default three months and the date of issuance would be changed to three months after original date. The effect of this redate of the date of issuance is, of course, to extend the maturity date a period of time equal to the period redated. This redate privilege is extended to the holder for a period of ten years after the contract is issued. The holder exercising this redating privilege is to pay a reinstatement fee of from \$1 to \$5.³⁰

Holders may assign their certificates but a fee of \$1 is charged by the company for each transfer. All certificates carry the privilege of conversion, at any time prior to maturity, of the certificate into a "paid-up certificate" status for deferred settlement at maturity, determined according to the attained reserve value (attained surrender value plus some reserves).³¹ A paid-up certificate is a certificate which the Association issues after default in payments, the face amount of which is the sum of the surrender value at the time of default plus interest compounded at a specified rate to maturity, and which matures as of the date of original maturity. The time basis of conversion varies with the type of certificate, after certain minimum payments have been made.³²

From 10 to 16 monthly payments, including the initial payment, on a monthly basis must be made on all certificates issued since 1925

²⁹ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 34 (e); see also Public Examination, Fidelity Investment Association, at 21626, et seq.

³⁰ For contracts currently issued the period is 10 years, while for certificates or contracts issued prior to the Income Reserve Contract, the redate privilege was perpetual.

³¹ For more detailed discussion of paid-up certificates see *infra*.

³² The various time bases are as follows: Special Income Contract: After the initial payment, consisting of 1 to 6 installment payments, and 36 monthly payments (not sold since 1925); Special Annuity Contract: After the initial payment, consisting of 1 to 6 installment payments, and 6 monthly payments; Income Reserve Contract, Series A: After an initial payment, consisting of from 1 to 6 installment payments, and 6 monthly payments; Income Reserve Contracts, Series B and Series D: 12 monthly payments (no initial payment); and Income Reserve Contract, Series C: Initial payment, consisting of from 1 to 10 payments, in full.

A tabular description of these different types of certificates will be found in Appendix N, p. 164.

before such certificates attain any cash surrender or loan value.³³ For these same certificates or contracts, the cash surrender values do not equal in amount the total of the holders' payments until they have been in force and outstanding for a period of from 6 to 9 years.³⁴ In other words, a certificate holder must make his required payments regularly for a minimum of 6 years, in some cases 9 years, before he receives from the Association as much money as he has paid on his certificate.

D. Expense Deductions

All the certificates provide, under Reserve Fund conditions, for deductions by the Association for administrative and agency charges or expenses but do not specify the amount of such deductions. A periodic analysis of the Income Reserve Contract, Series B (which had certificates of a face amount of \$49,394,000 outstanding at the end of 1936, with and without insurance provisions, illustrative of installment payments of \$7.50 per month for 126 months, expense allowances, as deductions from installment payments, balances available for investment, and cash surrender values), is given in Table 20.³⁵

TABLE 20.—*Expense deductions and cash surrender value of Income Reserve Contract, Series B, issued by Fidelity Investment Association*

Period, first month, second month, etc.	Installment payments (cumulative)	Expense allowance (cumulative)		Available for investment (cumulative)		Cash surrender value (cumulative)	
		With insurance	Without insurance	With insurance	Without insurance	With insurance	Without insurance
8.....	\$60.00	\$60.00	\$50.00	0	\$4.00	0	-----
9.....	67.50	62.65	58.15	\$4.85	9.35	0	-----
11.....	82.50	64.35	58.85	18.15	23.65	0	-----
12.....	90.00	65.20	59.20	24.80	30.80	\$25.00	\$31.13
18.....	135.00	70.30	61.30	64.70	73.70	65.50	74.79
24.....	180.00	75.40	63.40	104.60	116.60	107.50	120.03
30.....	225.00	80.50	65.50	144.50	159.50	149.50	165.34
36.....	270.00	85.60	67.60	184.40	202.40	193.00	212.23
42.....	315.00	90.10	69.10	224.90	245.90	236.50	259.19
48.....	360.00	94.60	70.60	265.40	289.40	281.50	307.73
54.....	405.00	99.16	72.10	305.90	332.90	328.00	357.85
60.....	450.00	103.60	73.60	346.40	376.40	374.50	408.05
66.....	495.00	106.90	75.40	388.10	419.60	422.50	458.32
72.....	540.00	110.20	77.20	429.80	462.80	473.50	511.62
78.....	585.00	113.50	79.00	471.50	506.00	524.50	565.01
84.....	630.00	116.80	80.80	513.20	549.20	577.00	619.93
90.....	675.00	118.90	81.40	557.10	593.60	631.00	676.41
96.....	720.00	121.00	82.00	599.00	638.00	686.00	734.45
102.....	765.00	123.10	82.60	646.90	682.40	745.00	795.54
108.....	810.00	125.20	83.20	684.80	726.80	806.50	859.70
114.....	855.00	126.70	83.20	728.30	771.80	872.50	928.41
120.....	900.00	128.20	83.20	771.80	816.80	941.50	1,000.18
126.....	945.00	129.70	84.70	815.30	860.30	1,015.00	1,075.00
Percent of total installments....	100.0	13.7	9.0	86.3	91.0	107.4	113.8

³³ The "initial payment" is a definite total amount, payable in 1 or more payments up to 10, on a monthly basis. The total amount and maximum number of allowable payments vary for different types of certificates.

³⁴ In one type of contract the period is 6 years, in three types 7 years, and in one type 9 years.

³⁵ Public Examination, Fidelity Investment Association, at 21625.

In successive monthly order expense charges were:

Months	Monthly charge	
	With insurance	Without insurance
1 to 8.....	\$7.50	\$7.00
9.....	2.65	2.15
10 to 36.....	.85	.35
37 to 60.....	.75	.25
61 to 84.....	.55	.30
85 to 108.....	.35	.10
109 to 126.....	.25	(^a)

^a 109 to 120 months—no expense charge; 121 to 126 months—25 cents per month.

As to certificates of this series, cash surrender values attain amounts equivalent to total installment payments after the end of the ninth year for certificates with insurance provisions and after the seventh year for certificates without insurance provisions.

Allowing for the difference in the installment rate,³⁶ results produced by this analysis agree substantially with those for Income Reserve Contract, Series B, and for the sizably important Income Reserve Contract, Series A, the sale of which was discontinued in 1934.

The above table shows that for the certificates without insurance, the amounts available for investment by the Association (the total amount of the installment payments less expense deductions such as salesmen's commissions, administration costs) were \$4.00 at the end of the eighth month, \$9.35 at the end of the ninth month, and \$23.65 at the end of the eleventh month. Notwithstanding the fact that these amounts are available to the Association for investment, the certificates are without any surrender value whatsoever until the end of the twelfth month. Consequently, any certificate holder who lapses or abandons his certificate after any installment payments up to and including the eleventh month after issuance, loses the entire amount of his payments, despite the fact that there are balances available for investment after the eighth, ninth, and eleventh monthly payments.

E. Security Provisions

All types of contract provide for the creation and maintenance of reserves collaterally secured by the deposit of approved securities as required by the laws of West Virginia. In general, it is provided in the certificates or contracts that amounts shall be set aside out of payments by certificate holders which with interest thereon at specified rates per annum ³⁷ will, on dates specified in the certificates,

³⁶ \$10 per month for 10 months initial payments and 132 monthly payments.

³⁷ The interest rates on the deposit for contracts of the various series are as follows:

Income Reserve Contract, Series A, 4% compounded quarterly.

Income Reserve Contract, Series B, 4½% compounded semiannually.

Income Reserve Contract, Series C, 4% compounded quarterly.

Income Reserve Contract, Series D, 4% compounded annually.

Special Annuity Contract, 4½% compounded semiannually.

equal or exceed the Association's cash liability thereon. Any operating or other contingent deficiency in the fund is a liability of the Association.

In a bill of complaint filed by the Commission against the Association on December 14, 1938, in the District Court of the United States for the Eastern District of Michigan ³⁸ it was alleged, *inter alia*, that the Association had failed to keep and maintain these reserves properly according to the covenants in the certificates. The bill alleged that the Association did—

fail to maintain at all times the required reserves against existing contract liabilities, and fail adequately to restore by contribution from the general fund deficiencies existing at various times in specific contract funds * * *.

In its answer, filed December 22, 1938, the Association entered a general denial to this allegation. However, on December 22, 1938, a final judgment was entered, by consent, enjoining the Association against—

Failing to create and maintain separate contract reserve funds, or permitting cash over-drafts between various contract funds; or

Failing to maintain required reserves; or

Transferring to Defendant's general funds gains belonging to contract funds; or

Transferring or selling securities from one contract fund to another contract fund, or between contract funds and the general fund * * *.

The collateral trust certificates issued and sold by Fidel Association of New York, Incorporated, wholly owned subsidiary of Fidelity Investment Association organized to sell certificates in the State of New York, ³⁹ require the deposit of securities with a designated trustee ⁴⁰ under the terms of a trust agreement. The trust agreement provides that the actuarial value of the fund or deposit shall at all times equal at least the total of the Company's liability on outstanding certificates.⁴¹ The certificates are guaranteed by the Association.

IV. SALE OF THE SECURITIES OF THE CORPORATION

A. Sale of Stock

The Association sold some of its capital stock to the general public in limited amounts. Practically all of this capital stock thus

³⁸ See Appendix X, p. 197, for a description of these proceedings and the documents filed therein.

³⁹ The Fidel Association of New York, Incorporated, serves a purpose similar to that served by Investors Syndicate Title & Guaranty Company.

⁴⁰ The Charleston National Bank, Charleston, West Virginia, is the trustee named in the indenture and was acting as such at December 31, 1937. The Central Hanover Bank and Trust Company was the depository. See the reply to the Commission's questionnaire for Fidelity Association of New York, Incorporated, Item 21.

⁴¹ The determination of the actuarial value of the fund is under the terms of the trust agreement to be made at specified times by a consulting actuary, who may be a consulting actuary for the company.

sold was issued to holders of certificates in exchange for their certificates or contracts of the Association, the cash surrender value of such certificates being used for payment of the capital stock. The following is a resumé of the stock issued during the period January 1, 1927–December 31, 1936:

Preferred Stock, Series A.—5,051 shares of preferred stock sold in 1931 and 1932 for cash at \$110 per share, yielding \$555,610 gross and \$505,100 net to the Association; 4,059 shares of preferred stock issued in 1936 as a stock dividend on the common stock. A total of 9,110 shares of preferred stock was thus issued during the period.

Common Stock.—599 shares of common stock sold for cash for a total of \$114,437; 4,524 shares of common were issued in 1928 and 1929 (1,875 and 2,649 shares, respectively) as stock dividends on the common stock.

Sales of the common stock by years were as follows:

1927-----	75 shares for	\$9, 375
1928-----	50 shares for	6, 357
1929-----	300 shares for	65, 000
1930-----	75 shares for	16, 875
1931-32-----	99 shares for	16, 830
<hr/>		<hr/>
Total-----	599	114, 437

The total maturity settlement amounts, i. e., face amounts, of investment certificates exchanged for preferred stock in 1931 amounted to \$1,893,353 and in 1932 to \$3,687,741, a total for the 2 years of \$5,581,094. The total surrender value represented by these certificates exchanged for the preferred stock is not available, but probably approximates the amount shown as gross proceeds of sale, viz, \$555,610.⁴²

B. The Investment Certificates

1. CERTIFICATES SOLD

The installment investment certificates are sold continually by salesmen who are paid on a commission basis. Total sales by years from 1927 through 1936, with total monthly installment payments by the purchasers, are shown in Table 21.⁴³

⁴² The average cash surrender values for the years 1931 and 1932 were 12% and 10%, respectively, of the maturity settlement amounts of all certificates in force and outstanding during those years.

⁴³ This table shows figures both including and excluding transfers from contracts of one type to contracts of another type, and includes the maturity settlement amount of certificates outstanding January 1, 1927.

TABLE 21.—*Sales of certificates by Fidelity Investment Association, annually, 1927-36*

Year	Number of certificates	Contracts, including transfers from one type to another		Contracts, excluding transfers from one type to another	
		Maturity amount of writings (000 omitted)	Payments by certificate holders (000 omitted)	Maturity amount of writings (000 omitted)	Payments by certificate holders (000 omitted)
1927.....	3,886	\$21,602	\$3,277	\$16,004	\$2,974
1928.....	9,017	27,394	3,911	22,440	3,698
1929.....	13,745	46,520	5,556	41,382	5,273
1930.....	16,531	57,778	7,113	52,280	6,865
1931.....	20,739	66,718	8,466	60,626	8,065
1932 ^a	17,439	52,862	8,543	33,958	2,267
1933.....	14,197	39,820	7,209	17,903	3,775
1934.....	12,936	31,870	5,719	23,604	4,358
1935.....	12,666	29,355	6,450	18,685	5,741
1936.....	12,564	27,166	6,279	25,760	6,214
Total.....	133,720	401,085	62,523	312,642	49,230
In force Jan. 1, 1927.....	30,858	87,527	^b 10,451	87,527	^b 10,451
Grand total.....	164,578	488,612	72,974	400,169	59,681

^a From 1932 to 1936 the table includes Fidel Association of New York, Inc.

^b Book reserve at Jan. 1, 1927.

The total maturity amount of certificates affected by duplications through transfers from one type of certificate to another was \$88,443,000 and payments by certificate holders similarly affected amounted to \$13,293,000. The total face amount of contracts or certificates including transfer duplications was \$488,612,000; excluding such duplications, \$400,169,000. The total payments by certificate holders including the transfer duplications amounted to \$72,974,000; excluding such duplications, \$59,681,000.

There were 96,245 certificates in force and outstanding at December 31, 1936, having a total maturity settlement or face amount of \$247,062,000.⁴⁴ Subtracting these amounts from the totals of certificates issued, as shown above, leaves a balance for certificates surrendered⁴⁵ and matured during the period of 68,333 certificates of a total maturity or face amount of \$241,550,000. Of the certificates in force and outstanding at the end of 1936, representing a face amount of \$247,062,000, a total of \$37,004,000, in face amount, contained life insurance provisions, with a total insurance coverage of \$15,158,001.50. If the surrendered and matured certificates of a maturity amount of \$241,550,000 are reduced by transfers of \$88,443,000 from certificates of one type to those of another type, the total maturity amount of terminated certificates becomes \$153,107,000 for the period.

2. CHANGES IN TYPES OF CERTIFICATES

Since 1932 all certificates issued by the Association have been designated Income Reserve Contracts and have been issued under serial

⁴⁴ Including certificates of Fidel Association of New York, Inc.

⁴⁵ Figures for surrenders include a very small number of lapsed certificates applicable to a series written prior to 1919.

order as Series A, B, C, and D. The sale of Series A was completed in 1934. Series B and Series D are being currently offered. Series C was a "special employment" plan, for which total sales were small. Sale of Series C was discontinued in 1935. There have been some changes in the maturity settlement amounts of the different series and in the Reserve Fund interest rates.⁴⁶

3. SALES ORGANIZATION

a. General Description

Prior to September 7, 1934, all sales of certificates were made through an independent corporation known as National Sales Agency, Incorporated, as general sales agency.⁴⁷ Up to this date the salesmen who actually made the sales were employees of this company and not of the Association. The Association paid commissions directly to the sales agency. This arrangement was terminated on September 7, 1934, and since that time the Association has employed and paid the salesmen directly.

Sales are made by direct, personal contact by the salesmen with the prospects. General sales headquarters are located at the main office of the Association in Wheeling, W. Va. The selling organization is under the supervision of a director of agencies, who is vice president of the Association. Both solicitors and branch-office sales executives are compensated on a straight commission basis.

At December 31, 1935, the Association had 28 branch sales offices located in the principal cities of the states in which the certificates are sold. Nineteen of the offices were in four states, namely, seven in Pennsylvania, five in West Virginia, four in Ohio, and three in Michigan. A list of the branch offices, with the number of employees⁴⁸ in each is as follows:

Branch office location	Number of employees	Branch office location	Number of employees	Branch office location	Number of employees
Wheeling, W. Va.....	26	Cleveland, Ohio.....	59	Nashville, Tenn.....	12
Charleston, W. Va....	15	St. Louis, Mo.....	20	Wilmington, Del.....	3
Chicago, Ill.....	64	Allentown, Pa.....	10	Bluefield, W. Va....	7
Washington, D. C....	15	Richmond, Va.....	5	Columbus, Ohio.....	10
Philadelphia, Pa.....	40	Atlanta, Ga.....	2	Dayton, Ohio.....	9
Pittsburgh, Pa.....	37	Parkersburg, W. Va..	14	Flint, Mich.....	3
Reading, Pa.....	12	Milwaukee, Wis.....	75	Lansing, Mich.....	4
Harrisburg, Pa.....	17	Cincinnati, Ohio.....	10	Huntington, W. Va...	6
Baltimore, Md.....	13	Wilkes-Barre, Pa....	13		
Detroit, Mich.....	55	Scranton, Pa.....	14	Total.....	57

⁴⁶ From 4½% compounded to 4% compounded.

⁴⁷ The Association reported that there was no intercorporate relationship between it and National Sales Agency, Incorporated, except as represented by the agency contract. See the reply to the Commission's questionnaire for Fidelity Investment Association, Item 27. See also Public Examination, Fidelity Investment Association, at 21665 et seq. A discussion of the relationship will be found infra, Sec. VIII, *Management of Assets*, p. 96.

⁴⁸ The majority of these employees are salesmen, only a few employees in each office being clerks, bookkeepers, and stenographers.

For the sale of the certificates of Fidel Association of New York, Incorporated, offices are maintained in several cities in order to facilitate sales in New York and Connecticut. A list of such offices, together with the number of employees therein, is as follows: ⁴⁹ New York City, 45 employees; Buffalo, 12 employees; Elmira, 7 employees.

b. Sales Personnel

The business of the Association rests on the salesmen occupied continually in door-to-door solicitation. There were 766 such salesmen at December 31, 1936, compared with 634 at the end of 1935. The number of salesmen has varied during the period 1927-1936 from a low at the year-end 1928 of 450 to a high at the year-end 1931 of 940.

There is a high rate of turn-over in salesmen. Figures for the year 1936 may be cited as an example. ⁵⁰ In that year there were 634 salesmen at the beginning of the year, 1,182 new salesmen were hired, and 1,050 left the employ of the Association during the year. There were thus 132 net additions to the sales force during 1936, bringing the total number of salesmen employed to 766 at the year-end.

The Association has reported that experience indicates that the most effective salesmen are those having previous sales experience, particularly of a commercial or industrial character. This experience is supplemented by a course of training by the Association. ⁵¹

It is the policy of the Association to secure from both old and new certificate holders the names of persons who might be solicited to purchase the investment certificates. ⁵²

4. COMMISSIONS PAID AND OTHER EXPENSE DEDUCTIONS

For the period from 1927 to 1936 installment payments by certificate holders aggregated \$49,230,000, of which the Association applied on its books as income ⁵³ a total of \$12,427,000, or 25.2%—25.2 cents of every \$1 of installment payments.

The salesmen's commissions are paid if, as, and when installment payments are collected. Total commissions paid during the period 1927-1936 amounted to \$9,308,000, a sum equal to 18.9% of total installment payments; i. e., 18.9 cents of every dollar paid by certificate holders were required to meet commission payments.

Commissions paid to National Sales Agency, Incorporated, during the existence of its agency agreement on three typical contracts, com-

⁴⁹ Reply to the Commission's questionnaire for Fidel Association of New York, Incorporated, Part II, Table 12. Additional offices, since closed, were maintained for a short time in New York City (uptown), Brooklyn, and Auburn. (Ibid.)

⁵⁰ Derived from supplementary information supplied the Commission by Fidelity Investment Association.

⁵¹ Reply to the Commission's questionnaire for Fidelity Investment Association, Items 27 and 28.

⁵² Ibid.

⁵³ Designated as "proportion of installments not applicable to reserves."

pared with total installment payments required and total expense allowance, were as follows: ⁵⁴

Contract	Total installment payments	Total expense allowance		Commissions paid	
		Amount	Percent of installment	Amount	Percent of installment
Special annuity, maturity amount (\$2,000)	\$1,320	\$104.00	7.88	\$60.00	4.55
Income reserve, series A, maturity amount (\$2,000)-----	1,420	110.25	7.76	67.00	4.72
Income reserve, series B, maturity amount (\$1,250)-----	945	84.70	8.96	46.60	4.93

In the Special Annuity Series, \$45.00 or 75% of total commissions paid were deducted out of the first six installment payments; in the Income Reserve Series A, \$61.00, or 90% of the total commissions paid were out of the first 10 installments; and in the Income Reserve Series B, the total commissions are paid out in the first eight months. The percentage of commissions of total installments for the three series were 4.55%, 4.72%, and 4.93%, respectively. As the series are in the order of the time of the sales thereof, it would appear that the ratio of commissions to installments has been steadily rising.

Commissions paid in entirety in eight months on certificates being presently issued on \$2,500 units of Income Reserve Contracts, Series B and \$2,400 units of Income Reserve Contracts, Series D, as divided among salesmen, branch and division managers may be summarized as follows: ⁵⁵

Payment according to method of sale

	By salesmen	By special representative
Salesmen-----	\$37.00	-----
Special representative-----	-----	\$47.00
Manager-----	16.00	13.50
Division manager-----	13.00	9.50
Total-----	66.00	70.00

The total commission paid, as shown, is equal to a total of more than four monthly installments of \$15 each and is equivalent to 3.6% of the total of all installments required to mature Series B contracts and to 3.8% for Series D contracts.

⁵⁴ Reply to the Commission's questionnaire for Fidelity Investment Association, Items 28 and 50.

⁵⁵ Ibid.

Table 22 shows total commissions paid, on a consolidated basis, and their percentage relationship to total sales,⁵⁶ from 1928 to 1936.⁵⁷

TABLE 22.—*Commissions paid to salesmen of Fidelity Investment Association, 1927-36*

Year	Commissions paid	Commission paid as percent of total maturity settlement amount of certificates sold, etc.	
		Including transfers from one type to another	Excluding transfers from one type to another
		Percent	Percent
1927.....	\$375, 181	1. 74	2. 34
1928.....	505, 448	1. 85	2. 25
1929.....	849, 831	1. 83	2. 05
1930.....	1, 125, 045	1. 95	2. 15
1931.....	1, 322, 332	1. 98	2. 18
1932.....	1, 318, 359	2. 49	3. 88
1933.....	1, 057, 170	2. 65	5. 90
1934.....	741, 941	2. 33	3. 14
1935.....	° 1, 097, 357	3. 74	5. 87
1936.....	° 915, 403	3. 37	3. 55
Total.....	9, 308, 067	2. 32	2. 98

° Includes bonus—1935, \$156,453 and 1936, \$160,593.

All commission payments to and including the year 1933, and \$378,753 of those paid in 1934 were made to National Sales Agency, Incorporated.⁵⁸ It is to be noted that sales of certificates and commission payments do not move coordinately. This is due normally to installment payments affected by commissions being paid over an extended period following sales, and which installment payments, because of delinquency, are considerably further extended in time beyond sales.

The certificates do not provide for any specific dollar limitation on expense deduction. The following provision is contained in the agreement for the Reserve Fund for Income Reserve Contract, Series B: ⁵⁹

The amount so set aside * * * with earnings thereon (4½% compounded semi-annually) and accretions thereto, shall be an amount equal to all payments made hereon, less fixed administrative and agency charges * * *.

It is further provided that the amount * * * set aside will, at any and all times to the dates specified in such contracts for surplus apportionment, equal or exceed the amount of cash payment liabilities of the Association under the terms of such contracts * * *.

⁵⁶ Representing a total maturity settlement amount of \$379,491,640.

⁵⁷ Based on estimated commuted cash value of 80% of maturity settlement amounts,, the percentages for commission paid, as shown in the above table, would be increased about 25%. Thus the percentage for 1927 of 2.34% would become 2.92%, and so on.

⁵⁸ Reply to the Commission's questionnaire for Fidelity Investment Association, Items 28 and 50.

⁵⁹ Id., Item 22.

Interest accretions are not based upon the total installment payments made, but upon such payments "less fixed administrative and agency charges." However, no statement of the amounts of deductions for such charges is shown in any certificate.

Interest at the rate of $4\frac{1}{2}\%$ on the reserve fund, as provided in the contract, does not mean $4\frac{1}{2}\%$ interest on the total of installments paid. To illustrate: the maturity period for Income Reserve Contract, Series B, is 126 months, with a commuted value of \$1,075, whereas if the reserve fund interest rate— $4\frac{1}{2}\%$ —were applied semi-annually to the total of *all installment payments*, instead of only that part of such payments after expense deductions, the commuted cash value at the end of 126 months would be \$1,218, or \$143 more than the actual contract amount of \$1,075. The actual or effective interest return to the investor is only about $2\frac{1}{2}\%$, compounded semi-annually, on the total of installments paid to maturity.

5. SALES LITERATURE

Prior to 1935 the Association confined its advertising to monthly enclosures of literature with payment notices to certificate holders, and the publication of financial statements in newspapers. In 1935 such statements appeared as advertisements in *Time*, a news-review magazine of national circulation.⁶⁰ It does not appear whether or not National Sales Agency, Incorporated, distributed any sales literature.

The advertising literature of the Association employs pictorial illustrations of the fruits of savings, testimonial letters from persons in different walks of life, and data relating to average earning power at different periods of life. In recent years this type of advertising has appeared in national periodicals.

The cost of advertising, on a consolidated basis, from 1928 through 1936 varied from a low of \$6,386 in 1928 to \$30,450 in 1935. For other years the amounts were: ⁶¹ 1929, \$14,067; 1930, \$15,468; 1931, \$23,127; 1932, \$20,995; 1933, \$10,416; 1934, \$13,730; and 1936, \$17,528. The total advertising costs for the period 1928–1936 of \$152,167 were 0.04% of the maturity settlement amount of total sales for the same period, or about 0.05% of the commuted cash value of such total maturity settlement amount.

V. SURRENDERS AND LAPSES OF CERTIFICATES

Investment certificates or contracts in a total maturity settlement amount of \$12,122,000 matured during the period from January 1, 1927, to December 31, 1936. The estimated commuted or actual cash value at maturity of these certificates was \$9,782,000—about 80% of their maturity settlement or face amount. During the period payments to holders of matured certificates amounted to \$9,907,000, and payments to holders who surrendered their certificates amounted to \$30,237,000, including credits allowed in the transfer from certificates of one type to another in the amount of \$13,293,000. Total payments to certificate holders who surrendered their certificates, excluding transfers, amounted to \$16,944,000. Against this latter sum the hold-

⁶⁰ Id., Item 27.

⁶¹ Id., Item 50.

ers of surrendered certificates paid to the Association a total of about \$24,454,000. The resulting loss to such holders as a whole was thus \$7,510,000. Table 23 shows, by years, payments to certificate holders.⁶²

TABLE 23.—*Payments to certificate holders of Fidelity Investment Association, 1927–36*

[Amounts in thousands of dollars]

Year	Matured certificates ^b	Other than matured certificates ^a		All certificates (payments only)
		Payments only	Payments and transfers	
1927.....	\$151	\$505	\$808	\$656
1928.....	242	555	768	797
1929.....	635	556	839	1,191
1930.....	959	545	792	1,504
1931.....	1,352	1,938	2,341	3,290
1932.....	1,652	2,857	9,133	4,509
1933.....	956	3,646	7,080	4,602
1934.....	1,440	2,700	4,060	4,140
1935.....	1,304	1,880	2,589	3,184
1936.....	1,216	1,762	1,827	2,978
Total.....	9,907	16,944	30,237	26,851

^a Surrendered and exchanged certificates.
^b Not actual but as computed by Corporation. Excludes payments on old contracts for which payments by certificate holders were lacking. The annual amounts were: 1927, \$370,000; 1928, \$118,000; 1929, \$13,000; 1930, \$3,600; and 1931, \$3,600; and the total was \$508,200. Accordingly, payments to "all certificate" holders aggregated \$27,359,200.

Payments and transfers to "other than matured certificate holders" of \$30,237,000 include some \$13,293,000, affected by application of certificate equities to installment payments on account of certificates of one series exchanged for outstanding certificates of another series and for certificates of the same series with conditions different from those of the exchanged certificates. If the amount representing exchanges, \$13,293,000, be deducted, the payments to holders of "other than matured certificates" become \$16,944,000.

By years these transactions were: ⁶³

Year	Transfers	Year	Transfers	Year	Transfers	Year	Transfers
1927.....	\$303,000	1932	\$6,276,000	1931.....	\$401,000	1936	65,000
1928.....	213,000	1933	3,434,000	Total.....			
1929.....	283,000	1934	1,361,000				13,293,000
1930.....	248,000	1935	709,000				

VI. PURCHASERS OF CERTIFICATES

The Association reported that it has never compiled any information as to the occupations or professions of its certificate holders. The

⁶² Id., Item 29.
⁶³ Ibid.

small amounts of installment payments, the extensive delinquency of certificates and the large number of premature terminations suggest that such holders, like those of certificates issued by Investors Syndicate, represent a broad range of activity and are drawn largely from lower income brackets.

A. Number of Certificate Holders and Certificates Outstanding

No data are available as to the number of certificate holders. Table 24 shows the number of certificates in force, the maturity settlement amount thereof, and the reserves (i. e., cash surrender values) applicable thereto as of year-ends from 1926 to 1936.⁶⁴

TABLE 24.—*Number of certificates in force, with the maturity settlement amounts and reserves, for Fidelity Investment Association, 1927–36*

Year	Certificates in force (number)	Maturity settlement amount		Reserve fund ^a (000 omitted)	Reserve fund as percent of estimated commuted value of maturity settlement amount ^b
		Total (000 omitted)	Average		
1926.....	30,858	\$87,527	\$2,836	\$10,451	14.9
1927.....	34,915	98,851	2,831	12,559	15.9
1928.....	40,969	116,728	2,849	15,290	16.4
1929.....	50,782	150,170	2,957	19,008	15.8
1930.....	62,621	191,765	3,062	23,905	15.6
1931.....	75,719	231,660	3,059	27,753	15.0
1932.....	79,917	236,064	2,954	23,671	12.5
1933.....	81,068	228,245	2,815	22,172	12.1
1934.....	84,960	229,124	2,692	22,604	12.3
1935.....	88,237	232,575	2,636	24,974	13.4
1936.....	96,245	247,062	2,567	28,702	14.5

^a Includes varying amounts of unrequired reserves. For 1936 the amount was \$1,591,000.

^b Commuted value considered as 80% of maturity settlement amount.

The average maturity settlement amount of certificates varied from a high of \$3,062 in 1930 to \$2,567 in 1936.⁶⁵ The average amount per certificate held by purchasers was slightly upward in trend from 1926 to 1931, after which the trend was downward, with material declines in the years 1934 and 1936.

The percentage relationship of the reserve fund, i. e., the total cash surrender value, to the estimated commuted value of maturity settlement amounts is a rough measure of completed installment payments. However, since the reserves are smallest—practically nothing—for the first 12 months after issuance of the certificates the ratio of installment payments made to the total of such payments required would be somewhat higher than indicated by the above table. It is observed that the percentage was constant at about 15% up to 1931; dropped sharply in 1932 to 12.5%, and remained around that level until 1936 when it rose to 14.5%.

⁶⁴ On a consolidated basis. See the reply to the Commission's questionnaire for Fidelity Investment Association, Item 31.

⁶⁵ The estimated commuted amounts would be \$2,450 and \$2,054, respectively

The average settlement amount of the certificates, \$2,567, commuted to \$2,054, further corroborates the conclusion that the purchasers of the certificates are persons of small means, as do the facts that the small monthly payments required are in an extended state of delinquency; and there is a high rate of surrenders for cash.⁶⁶

B. Geographical Distribution of Certificates in Force

The Association reported that it had compiled no data on the geographical distribution of certificate holders.⁶⁷ However, a tabulation of the geographical distribution of certificates outstanding at June 30, 1937, according to "required reserves" and the populations of the states and the District of Columbia has been compiled and will be found in Appendix O. While maturity amounts of outstanding certificates are lacking in the tabulation the required reserves may be regarded as having a relation, as indicated, to the population figures corresponding to the maturity amounts. In other words, if maturity amounts by states were available they would probably show approximately the same percentages as are shown for required reserves.

Assuming for certificates outstanding a constancy of relationship between maturity amounts and required reserves, the states with the highest relative investment in the investment certificates, contrasted with population, are:

State	Percentage of total required reserve	Percentage of population	Density ratio of business (reserve basis) to population
Delaware.....	1.19	0.20	6.0
District of Columbia.....	4.57	.47	9.7
Illinois.....	18.46	6.13	3.0
Maryland.....	2.64	1.31	2.0
Michigan.....	9.42	3.65	2.6
Ohio.....	8.26	5.26	1.6
Pennsylvania.....	23.19	7.89	2.9
West Virginia.....	10.68	1.42	7.5
Wisconsin.....	5.29	2.28	2.3
Total.....	83.70	28.61	• 2.9

^a Average.

Thus residents of these eight states and the District of Columbia, with about 29% of the total population, have some 84%, on the basis of "required reserves," of the total investment in the certificates of the Association. The states which show required reserves of relatively 2½ times their respective population percentages or more are, in the

⁶⁶ Officials of the Association have contended, in informal statements to the Commission, that certificate holders were not of small means and in support of that statement have averred that some 750 bankers throughout the country were certificate holders. No evidence was furnished by these officials as to the income of these bankers.

⁶⁷ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 32.

order of their rank: District of Columbia, 9.7; West Virginia, 7.5; Delaware, 6.0; Illinois, 3.0; Pennsylvania, 2.9; and Michigan, 2.6.

VII. CERTIFICATE RESERVES ⁶⁸

At the end of 1927 total certificate reserves amounted to \$12,559,000 at book value. The total expanded by about \$3,000,000 to \$4,000,000 in each year from 1927 through 1931. In 1932 they declined by about \$4,000,000, and in 1933 declined further by about \$1,500,000. The amount of total reserves remained about the same in 1934 but increased by about \$2,500,000 during 1935, and further increased by about \$3,000,000 in 1936. From a total of \$12,559,000, book value, at the end of 1927, the total of these reserves had risen to \$27,753,000, book value, by the end of 1931; declined to \$22,172,000, book value, by the end of 1933; and risen to \$28,702,000, book value, by the end of 1936. Table 25 shows for each year during the period the reserves, certificates in force, and the percentage relationship of the reserves.⁶⁹

TABLE 25.—*Face amount and certificate reserves for certificates in force of Fidelity Investment Association, annually, 1927–36*

December 31	Face amount certificates in force	Certificate reserves (book value) ^a	Reserves as percentage of certificates in force
			<i>Percent</i>
1927.....	\$98,851,000	\$12,559,000	12.7
1928.....	116,728,000	15,290,000	13.1
1929.....	150,170,000	19,008,000	12.6
1930.....	191,765,000	23,995,000	12.5
1931.....	231,660,000	27,753,000	12.0
1932.....	236,064,000	23,671,000	10.0
1933.....	228,245,000	22,172,000	9.7
1934.....	229,124,000	22,604,000	9.9
1935.....	232,295,000	24,974,000	10.8
1936.....	247,062,000	28,702,000	11.6

^a Includes varying amounts for unrequired reserves. In 1936 the amount was \$1,591,000.

The drop in percentages in the period 1932–1934 is due to the effect of cancellations against certificate reserves by reason of certificate loans.

During 1931 and 1932 there were (1) exchanges of outstanding certificates for preferred stock, using the cash value of certificates to pay for the stock, and (2) heavy surrenders of certificates for cash, doubtless due to the effects of the depression. An additional factor in 1933 was the application by the Association of certificate reserves toward the liquidation of loans on certificates to which such reserves were applicable.

⁶⁸ See Appendix X, p. 197, for a discussion of recent developments in connection with these reserves.

⁶⁹ Reply to the Commission's questionnaire for Fidelity Investment Association, Items 48 and 50.

The annual rates at which interest accumulates on the several reserve funds are as follows: Income Reserve Contract, Series A, Income Reserve Contract, Series C, and Collateral Trust Certificates, Series A, 4% compounded quarterly; Special Annuity Contract, Income Reserve Contract, Series B, and Collateral Trust Certificates, Series B, 4½% compounded semiannually;⁷⁰ and Income Reserve Contract, Series D, 4% compounded annually.⁷¹

The reserves for certificates outstanding and in force at December 31, 1936, together with maturity settlement amounts and percentages of reserves to commuted cash value at maturity, were as follows:⁷²

Contract series	Date of first issue	Date sales discontinued, etc.	Maturity amount outstanding (000 omitted)	Amount of reserve fund (000 omitted) ^a	Percent of reserve to 80 percent ^b of maturity amount outstanding
Special income.....	December 1920.....	April 1925.....	\$32,813	\$1,984	7.6
Special annuity.....	April 1925.....	March 1932.....	112,171	13,966	15.5
Income reserve A.....	March 1932.....	June 1934.....	34,329	4,937	18.0
Income reserve B.....	June 1934.....	In offering.....	49,394	3,531	8.9
Income reserve C.....	March 1935.....	— 1935.....	101	20	25.0
Income reserve D.....	July 1935.....	In offering.....	5,329	147	3.4
Collateral trust A.....	July 1932.....	January 1935.....	8,047	1,048	16.3
Collateral trust B.....	January 1935.....	In offering.....	4,877	399	10.2
Total.....	247,061	26,032	13.2

^a Required reserve.

^b 80 percent of maturity amount (deferred settlement amount) is estimated commuted payment or present value at time of maturity.

The Special Income Series contracts, which were not sold after 1925, had at the end of 1936 a reserve equal to only 7.6% of the commuted or present value at maturity of such certificates in force. As of this same date, about 4½ years after their sale was discontinued, the Special Annuity Contracts had an applicable reserve equal to only 15.5% of the commuted maturity value of such certificates in force. Because of the lapse of time since the sale of these contracts ceased, it is improbable that a large amount of installment payments will be made on the outstanding certificates. It is therefore, estimated that about 80% of the Special Annuity Contracts and 90% of the Special Income Contracts will fail to reach maturity—a potentially high state of surrender.

VIII. MANAGEMENT OF ASSETS

A. General

The Association has followed a settled policy of investing its funds almost entirely in marketable securities, about 90% of which have consisted of bonds and notes. Investments in stocks have consisted

⁷⁰ No rate of interest for the reserve fund of Special Income Contract was shown.

⁷¹ Reply to the Commission's questionnaire for Fidelity Investment Association, Items 22, 48, and 50.

⁷² Ibid.

principally of preferred stocks and have been, in the main, too small in amount to be of any importance.

These investments in securities have ranged from about 60% to 80% of the total assets of the Association. The drop from 80% to 60% was due principally to increases in loans, particularly certificate loans, which varied during the period 1927-1936 from a low of about 7% to a high of 31% of total assets. These loans were at their highest in the years 1930, 1931, and 1932, and reflect the effects of the depression. Cash was a relatively large item in 1930, 1931, 1932, 1935, and 1936. Table 26 gives the general types of the Association's assets for the period 1927-1936.⁷³

TABLE 26.—*Classification of assets of Fidelity Investment Association, 1927-36 year-ends*

[Amounts in thousands of dollars]

Year	Cash	Bonds and stocks ^a	Certificate loans	Other loans ^b	Real estate	Other assets	Total
1927.....	217	11,851	2,369	296	66	-----	14,799
1928.....	258	13,914	2,632	215	66	-----	17,085
1929.....	258	14,995	4,360	417	62	59	20,151
1930.....	1,014	16,586	6,903	406	50	88	25,047
1931.....	770	18,373	8,918	896	50	129	29,136
1932.....	933	16,729	6,162	1,160	152	149	25,285
1933.....	547	18,331	3,951	1,130	152	174	24,285
1934.....	375	19,448	2,733	1,193	166	251	24,166
1935.....	789	21,838	2,548	1,033	264	306	26,778
1936.....	1,062	25,791	2,308	919	272	596	30,948

PERCENT OF TOTAL

1927.....	1.5	80.0	16.0	2.0	0.5	-----	100.0
1928.....	1.5	81.4	15.4	1.3	.4	-----	100.0
1929.....	1.3	74.4	21.6	2.1	.3	0.3	100.0
1930.....	4.0	66.2	27.6	1.6	.2	.4	100.0
1931.....	2.6	63.1	30.6	3.1	.2	.4	100.0
1932.....	3.7	66.2	24.4	4.5	.6	.6	100.0
1933.....	2.3	75.5	16.3	4.6	.6	.7	100.0
1934.....	1.6	80.5	11.3	4.9	.7	1.0	100.0
1935.....	3.0	81.6	9.5	3.9	.9	1.1	100.0
1936.....	3.4	83.3	7.5	3.0	.9	1.9	100.0

^a Stocks generally were around 10 percent of the total.

^b These consist of collateral and mortgage loans; also year-end balances of advances to National Sales Agency: 1927, \$135,000; 1928, \$140,000; 1929, \$344,138; 1930, \$338,000; 1931, \$830,648; 1932, \$982,179; 1933, \$957,979; 1934, \$1,048,402; 1935, \$927,839; and 1936, \$858,918.

Investments in bonds as of December 31, 1936, on a consolidated basis, amounted to \$23,374,000 at book values and \$22,820,000 at market values. A classification of these bond investments is given in Table 27.

⁷³ On a consolidated basis and book values being shown. See the reply to the Commission's questionnaire for Fidelity Investment Association, Items 36 and 50.

TABLE 27.—*Classification of bond investments of Fidelity Investment Association, December 31, 1936*

Bonds	Book value		Market value	
	Amount (000 omitted)	Percent	Amount (000 omitted)	Percent
U. S. Government.....	\$742	3.2	\$771	3.4
Municipal.....	1,658	7.1	1,761	7.7
Federal farm loan.....	35	.1	36	.2
Railroad.....	4,531	19.3	4,524	19.8
Public utility *.....	7,589	32.5	7,741	33.9
Industrial.....	4,384	18.8	4,643	20.3
Financial.....	745	3.2	775	3.4
Foreign government.....	365	1.6	251	1.1
Foreign corporation.....	320	1.3	218	1.0
Real estate.....	3,005	12.9	2,100	9.2
Total.....	23,374	100.0	22,820	100.0

* Investments in holding companies represented a total of \$1,934,339 book value and a total of \$1,953,158 market value.

Except for the real estate bonds the difference between the book value of the investments in bonds and their market values is relatively small. The market value of the real estate bonds was about 70% of the book value.

Among the allegations in the Commission’s bill of complaint filed on December 22, 1938 against the Association was that the investment committee and directors of the Association used moneys of the Contract Funds and General Fund to purchase securities described as special situations, in which officers, directors and members of the Association had a personal financial interest, and in at least one instance to the personal benefit of various officers and directors of the Association. In its answer the Association admitted the transactions but denied fraudulent intent. In the final decree the Association was enjoined from “purchasing securities to the personal benefit of anyone connected directly or indirectly with [it].” ⁷⁴

B. Advances to National Sales Agency, Incorporated ⁷⁵

National Sales Agency, Incorporated, was the exclusive sales agency for the Association’s certificates throughout the period from January 1, 1927, to September 7, 1934. For all years from 1927 to 1935, inclusive, there is included among the Association’s assets advances to National Sales Agency, Incorporated, ranging in year-end totals from \$135,000 in 1927 to \$1,048,042 in 1934.

The annual certified audit report for the year ended December 31, 1934 contains the following statement with reference to this account: ⁷⁶

Advances to the National Sales Agency, Inc., as at December 31, 1934, amounted to \$1,048,402.81, an increase during the year of \$90,422.94. A voting trust agreement was executed on January 31, 1933, by F. W. King and A. L. King, majority

⁷⁴ See Appendix X, p. 197.
⁷⁵ See Appendix X, p. 197, for material relating to the recent status of this account.
⁷⁶ Reply to the Commission’s questionnaire for Fidelity Investment Association, Item 50.

stockholders of the National Sales Agency, Inc. Under the terms of this agreement, three appointees of the Association are empowered for a period of six years to vote the stock so deposited * * * on or about September 7, 1934 certain assets and liabilities of the National Sales Agency, Inc. were segregated and incorporated in new accounting records in which are recorded transactions of the trustees under the agreement. Disbursements for commission by the Association for account of the Sales Agency are made to the trustee.

In 1936 this claim of the Association against National Sales Agency, Incorporated, was split into two parts and transferred by the Association to Paull Company and Marston Corporation, both wholly-owned subsidiaries. The aggregate balance at December 31, 1936, was \$858,918.24 of which \$731,636.39 was carried by Paull Company and \$127,281.85 was carried by Marston Corporation.⁷⁷ These claims became part of the assets against which these subsidiaries issued collateral trust certificates to the Association, which had a face amount of \$4,413,000 at December 31, 1936.⁷⁸ A. L. King, one of the majority stockholders of National Sales Agency, Incorporated, was vice president and comptroller of the Association at December 31, 1936.⁷⁹

The only assets of National Sales Agency, Incorporated, are the rights to commissions applicable to installments on certain outstanding certificates issued prior to September 7, 1934. How much of the indebtedness can be ultimately paid by the application of such commissions is conjectural. During the years 1935 and 1936 the indebtedness was reduced from \$1,048,402.81 to \$858,918.24, a total reduction of \$189,484.37. Since the bulk of the selling commissions are payable out of the early installments and sufficient time has elapsed to have cleared all payments on outstanding certificates not in arrears, it appears doubtful that this indebtedness will be ever substantially reduced.

In its bill of complaint against Fidelity Investment Association,⁸⁰ the Commission alleged that the management of the Association transferred certain questionable assets to Paull Company, Marston Corporation, and Marietta Company⁸¹ in order, among other things, "to conceal the indebtedness of the insolvent and dormant National Sales Agency, Inc., to the General Fund and to the various Contract Funds."⁸² In its answer, the Association denied that the subsidiaries named were organized to conceal the indebtedness as alleged.⁸³ The final judgment of the District Court perpetually enjoined and restrained the Association, among other things, from "creating or maintaining subsidiaries to conceal the nature or amount of indebtedness or investments, or employing any other device, scheme, or artifice to defraud."⁸⁴

⁷⁷ Id., Item 4.

⁷⁸ Ibid.

⁷⁹ At December 31, 1935, A. L. King was a director and assistant treasurer of the Association and owned 704 shares of its common stock, being 8% of such stock outstanding. See *supra*, Sec. II, *Capitalization, Control and Affiliations*, p. 76.

⁸⁰ See Appendix X, p. 197.

⁸¹ Marietta Company was a subsidiary organized in 1936. For a discussion of the other 2 subsidiaries, see *supra*, Sec. II, *Capitalization, Control and Affiliations*, p. 76.

⁸² See Appendix X, Complaint, p. 197.

⁸³ Id., Answer of Defendant, p. 249.

⁸⁴ Id., Final Judgment, p. 257.

C. Ratio of Gross Income and Operating Expenses, Etc., to Average Total Assets ⁸⁵

The result of operations of the Association for the 10-year period 1927-1936, according to the percentages of average total assets represented by gross income,⁸⁶ operating expenses and interest, and profit and loss were as follows:

Year	Gross income as a percent of average total assets			Operating expenses, interest and profit and loss as percent of average total assets			
	Income excluding installment deductions	Installment deductions	Total gross income	Operating expenses excluding interest ^a	Interest	Profit and (loss)	Total operating expenses, interest and profit and loss
1927.....	6.7	4.2	10.9	3.9	6.5	0.5	10.9
1928.....	6.2	4.5	10.7	4.3	5.9	.5	10.7
1929.....	6.9	6.1	13.0	5.8	6.3	.9	13.0
1930.....	5.6	6.4	12.0	6.1	5.4	.5	12.0
1931.....	3.5	6.4	9.9	6.0	3.4	.5	9.9
1932.....	^b (.5)	6.2	5.7	6.2	^b (.4)	(.1)	5.7
1933.....	4.9	5.4	10.3	5.6	4.5	.2	10.3
1934.....	6.0	4.2	10.2	4.6	5.0	.6	10.2
1935.....	8.1	5.7	13.8	6.3	6.9	.6	13.8
1936.....	10.9	4.6	15.5	5.7	8.1	1.7	15.5
Period.....	5.8	5.4	11.2	5.6	5.0	.6	11.2

^a Includes interest earnings of reserve funds applied to such funds.

^b Gives effect to loss of \$1,190,000 from sale of securities.

Income for the period excluding deductions from installment payments was equal to 5.8% of average total assets, compared with operating expenses of 5.6% and interest requirements of 5.0%, a total requirement for interest and operating expenses of 10.6%. In other words, on the basis of average total assets the Association required 4.8% more to pay its expenses and service its investment certificates than it earned on its assets. The Association apparently is able to continue in business and make a profit by appropriating to income a large part of the installment payments in the early months after the issuance of the certificates.

Procurement, administrative, and other costs deducted from the installment payments aggregated \$12,427,000 for the 10-year period, of which \$9,307,000 represented selling commissions. For the same period other operating expenses, exclusive of interest, amounted to \$3,406,000. The ratio of commissions to other operating expenses was 2.7 to 1.⁸⁷

For the period 1927-1936, net realized profits from the sale of investments aggregated \$740,000 or about 50% of the total profits for the period.⁸⁸

⁸⁵ Appendix S, p. 171, consists of an analysis of surplus accounts of the Association from 1927 to 1936, inclusive.

⁸⁶ Gross income is divided into two parts, (1) income exclusive of that received from installment payments, and (2) income received by deductions from installment payments.

⁸⁷ See Appendix S, p. 171.

⁸⁸ This excludes similar transactions accounted for through several reserve funds.

The book values, in most cases cost, of the investments of the Association compare with market values and West Virginia Insurance Commissioner's values as follows:⁸⁹

Year	Values (000 omitted)			
	Book ^a	Basis approved by West Virginia Insurance Commissioners ^b	Market ^c	Market value as percent of book value
1927.....	\$11,707	(^d)	\$11,964	102.2
1928.....	13,744	(^d)	13,822	100.6
1929.....	14,849	(^d)	14,118	95.1
1930.....	16,432	(^d)	14,321	87.2
1931.....	18,193	15,603	11,634	63.9
1932.....	16,590	14,290	10,591	63.8
1933.....	18,160	13,318	11,622	64.0
1934.....	19,448	17,839	14,790	76.0
1935.....	21,838	20,005	18,866	86.4
1936.....	25,791	(^d)	25,504	98.9

^a Variations from preceding table are due generally to omission herefrom of accrued interest included in preceding table.

^b For 1931 to 1933; thereafter designated "In accordance with requirements of the Insurance Commission of West Virginia" and "In accordance with provisions of Collateral Trust Indenture."

^c Includes some values as appraised by the Corporation.

^d Not shown.

In 1929, the market value of the assets declined to a point where total assets at market were equal to only 95.1% of book value. This decline continued to 1932, at which time total assets at market were equal to 63.8% of book value. From 1932 on, the market value increased year by year until 1936, when the market value of assets was equal to 98.9% of book value, according to statements submitted by the Association in reply to the Commission's questionnaire.⁹⁰ By years the net market depreciation of investments was as follows: 1931, 36.1%; 1932, 36.2%; 1933, 36.0%; 1934, 24.0%.

In its bill of complaint against the Association to enjoin certain alleged fraudulent practices, previously referred to, the Commission alleged that the Association represented "that bonds, preferred stocks, and other securities are valued at 'cost' or amortized value, without disclosing that said 'cost' is a book value in many instances artificially inflated by a selective process of interfund transfers."⁹¹ In its answer the Association entered a general denial of the allegation.⁹² The final judgment of the District Court perpetually enjoined the Association from obtaining money or property by means of untrue statements of material facts, concerning "the cost of portfolio securities, the book value of which has been or is enhanced or depressed."⁹³

⁸⁹ The insurance commissioner of West Virginia has apparently adopted a system of valuation whereby investments in bonds not in default may be carried at their face value.

⁹⁰ Year-end figures.

⁹¹ Appendix X, Bill of Complaint, p. 197.

⁹² Id., Answer of Defendant, p. 249.

⁹³ Id., Final Judgment, p. 257.

In its bookkeeping the Association segregates its assets according to the requirement of reserve funds created, respectively, by the terms of the various series of certificates outstanding.⁹⁴ This practice is also followed with respect to the assets of Fidel Association of New York, Incorporated.⁹⁵ Income from the reserve funds is treated separately from the general income of the Association. The certified audited statements of the Association reflect all assets and liabilities, including the special reserve funds, but such statements do not show any income from such reserve funds except for the years 1931 to 1935, inclusive, and in those years the income from the reserve fund is separate from transactions included in the income statement of the Association.⁹⁶

Income received by the Association for the period 1927-36 (exclusive of deductions from installment payments) compares with operating expenses and interest requirements as follows:⁹⁷

Year	Income (as qualified) (percent) ^a	Operating expenses and interest (percent) ^a	Income deficiency (percent) ^a	Deficiency as percent of income (as qualified) (percent) ^a
1927.....	6.7	10.4	3.7	55.22
1928.....	6.2	10.2	4.0	64.52
1929.....	6.9	12.1	5.2	75.36
1930.....	5.6	11.5	5.9	105.36
1931.....	3.5	9.4	5.9	168.57
1932.....	(.5)	5.8	6.3	-----
1933.....	4.9	10.1	5.2	106.12
1934.....	6.0	9.6	3.6	60.00
1935.....	8.1	13.2	5.1	62.96
1936.....	10.9	13.8	2.9	26.61
Period.....	5.8	10.6	4.8	82.76

^a Percentage of average total assets.

The year of lowest income was 1930, with a net operating loss of 0.5%. This was due to a large loss realized on sales of securities. The next lowest year was 1931 with income of 3.5%. The year 1936, showing an income percentage of 10.9 and a deficiency percentage of 26.61, thus showed the highest relative and actual income for the period. This was accounted for largely by the profits on sales of securities. For the entire period, 1927-36, the deficiency percentage of income to expenses and interest was 82.76. It must be noted that "income" as used here means earned income and excludes deductions from certificate holders' payments.

IX. INCOME, EXPENSES, AND DIVIDENDS

A. General

The Association's income accounts do not include statements of earnings on the various reserve funds set up on outstanding certifi-

⁹⁴ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 50.

⁹⁵ Ibid. See also the reply to the Commission's questionnaire for Fidel Association of New York, Incorporated, Item 50.

⁹⁶ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 50.

⁹⁷ Ibid.

cates.⁹⁸ The assets comprising the reserve funds are shown among the assets of the Association in the general balance sheet, and the corresponding certificate obligations are carried as liabilities. Consequently, the income accounts of the Association do not reflect all the income from its assets. That part of installment payments credited to reserve funds together with interest thereon—the Association guarantees a specified interest rate of accretion to each fund—purports to maintain the funds at amounts at all times equal to the full liability of the Association for cash surrender and maturity values.⁹⁹

The income account for the period from January 1, 1927 to December 31, 1936, excluding earnings on the reserve funds, may be summarized as follows:

INCOME

[Amounts in thousands of dollars]

Initial and monthly installments not applicable to reserve requirements \$12,427
Income from nonreserve investments:

Dividends	\$308	
Interest on bonds, call loans, and bank balances	829	
Interest on unrestricted fund account	44	
Interest on certificate and other collateral loans	428	
		1,609

Other income:

Net profit on investments sold	740	
Gain on contracts surrendered	98	
Transfer fees	9	
Participation in surplus earnings income reserve contract A and collateral trust A funds	399	
Appreciation of securities owned	8	
Miscellaneous	30	
		1,284
Total income, as qualified		15,320

EXPENSES

Commissions	\$8,990	
Bonus to National Sales Agency, etc	317	
		9,307
Operating expenses (Appendix R)		2,902
Life-insurance premiums		248
Other charges:		
Discount on underwriting and advance collections	17	
Additions to permanent assets	38	
Interest on borrowed reserve funds	^a 214	
Other interest	30	
Uncollected notes	6	
Write-offs and write-downs of stocks and bonds	64	
Amortizations, etc., of cost of farm land	5	
Miscellaneous	6	
		380

^a Includes \$41,000 transferred from surplus account.

⁹⁸ Id., Item 50. See discussion in preceding section.

⁹⁹ Ibid.

EXPENSES—Continued

Reserve appropriations:	(000 omitted)
Transfers -----	298
Death claims -----	28
Paid-up and matured contracts -----	717
Conversion of certificates into preferred stock -----	1
Required improvement to unrestricted reserves (see surplus account) -----	92
	<hr/> 1, 136
Total expenses -----	<hr/> 13, 973
Net income, before Federal income taxes -----	<hr/> 1, 347

B. Dividends

With respect to dividends the Association reported as follows:¹⁰⁰

During the period under review it was the policy of the Association to distribute, when warranted, relatively small amounts of cash to the Common Stockholders, the residue of the earnings being retained in the business, either permanently by Stock Dividends or transfer to the "Undivided Profit" account, which in our accounting, corresponds to the "Surplus" of other corporations. The cash so distributed in 1927 was 6% ; 1928 to 1931, 4% each year; and in 1932, 3%. No cash dividends have been paid since then (1935).

As most of the original holders of the Series A Preferred Stock were individuals who desired to have a "Fixed Income" and purchased this class of stock for that purpose, it has been the policy of the Association to continue the minimum required dividend of 5% since its issue in 1932. It will be noted that but three shares of Series A Preferred Stock was held by all of the Officers and Directors as of December 31, 1935.

Dividends were paid as follows:

Year	In capital stock (par value)	In cash		Total paid
		On preferred stock (per cent)	On common stock (per cent)	
1927 -----			\$18, 012 (6)	\$18, 012
1928 common stock ^a -----	\$187, 447		16, 619 (4)	204, 066
1929 common stock ^a -----	264, 900		20, 633 (4)	285, 533
1930 -----			32, 068 (4)	32, 068
1931 -----			31, 982 (4)	31, 982
1932 -----		\$15, 970 (5)	24, 152 (3)	40, 122
1933 -----		12, 544 (2½)		12, 544
1934 -----		37, 882 (7½)		37, 882
1935 -----		25, 255 (5)		25, 255
1936 preferred stock ^a -----	405, 900	35, 357 (7)	16, 235 (2)	457, 492
Period -----	858, 247	127, 008	159, 701	1, 144, 956

^a Paid on common stock.

¹⁰⁰ Id., Item 16.

In its bill of complaint against the Association, previously referred to,¹⁰¹ the Commission alleged that the Association caused to be created a General Fund "earned surplus" out of moneys or "profits" made available: by failing to restore adequately from the General Fund deficiencies in specific contract funds; by failure to provide out of surplus and undivided profits or current earnings, reserves for depreciation and against loss on sale of securities and for contingencies; in the transfer to the Association's General Fund of approximately \$400,000 of "Gains on Terminated Contracts—Annuity" which were alleged to accumulate, for the period 1925–1937, as accretions to the Special Annuity Active Fund, but recognized as belonging exclusively to persistent annuity contract or certificate holders; by means of bookkeeping entries, effecting the "sale" or transfer of securities between Contract Funds and between Contract Funds and the General Fund, usually at prices in excess of the then book value of the securities transferred; by increasing the so-called "cost" of the securities and the "profits" of said funds by well over \$1,000,000 by the end of 1937, and materially affecting the mechanics of evaluation for the purpose of surplus distribution. In its answer the Association denied that it failed to maintain the required reserves and that it had failed to restore deficiencies in the specific funds; denied that it was required by law to provide out of surplus, undivided profits or current earnings reserves for depreciation and against loss in sale of securities and for contingencies, as alleged; admitted that it made the transfers to the general fund of "Gains on Contracts—Annuity" but stated such transfers were made on advice of its auditors and attorneys; admitted that sales of securities were made between contract funds but averred that such practices had been voluntarily discontinued prior to the commencement of the proceedings; admitted the declaration and payment of the dividends as alleged but denied that the surplus was created through manipulation or otherwise improperly. The consent judgment, entered December 22, 1938, enjoined the defendant from perpetrating the above practices.¹⁰²

C. Compensation to Officers, Directors, and Others

The Association reported payments as compensation to officers and directors, in excess of \$10,000 per annum to each such individual, for the years shown as follows:¹⁰³

	1931	1933	1936
Number of persons paid \$10,000 or more.....	1	1	3
Office.....	(a)	(b)	(c)
Total amount.....	\$10,000	^d \$10,000	\$40,009
Highest amount.....	\$10,000	\$10,000	\$15,750

^a Vice president.

^b President.

^c In 1936 salaries amounting to \$10,000 or more were paid to the president, vice president, and comptroller. The president's salary for 1936 was \$15,750.

^d This salary was for 8 months of the calendar year 1933.

¹⁰¹ See Appendix X, p. 197.

¹⁰² Ibid.

¹⁰³ These figures include only those salaries amounting to \$10,000 or more in any one year to any one individual.

The compensation paid by the Association to employees other than officers and directors were reported for the year 1936 only. The sales representatives of the Association up to September 7, 1934, were employees of National Sales Agency, Incorporated. In 1936 seven employees of the Association each received more than \$10,000 from the Association. The combined total payments to such employees was \$116,089. The two highest amounts paid were \$25,777 and \$22,741.

Compensation paid for the period and for which data are available to persons other than officers, directors, and employees and amounting to \$10,000 or more to any one individual, etc., may be summarized as follows:

Year	General sales agency ^a	Litho-graphing contrac-tor ^b	Adver-tising	Audit-ing	Year	General sales agency ^a	Litho-graphing contrac-tor ^b	Adver-tising	Audit-ing
1927.....	\$375, 222	\$10, 993	-----	-----	1933.....	\$1, 057, 266	-----	-----	-----
1929.....	849, 831	11, 768	-----	-----	1935.....	156, 453	\$12, 430	\$15, 390	-----
1931.....	1, 322, 332	-----	-----	-----	1936.....	-----	-----	-----	\$10, 954

^a National Sales Agency, Inc.

^b Columbia Bank Note Co.

X. EXPERIENCE OF INVESTORS

The experience of purchasers of the Association's investment certificates appears to have been unsatisfactory, as a whole. The Association's certificate holders who were able to maintain their payments to maturity, as agreed, of course obtained the maturity amount of their certificates. But the group of certificate holders whose certificates lapsed or were surrendered before maturity—and this group constituted a large majority of all holders of terminated certificates—suffered substantial losses, both of capital and interest increment.

A. Payments by and to Certificate Holders ¹⁰⁴

The reserves against certificate liability amounted to \$10,451,000 at January 1, 1927, and payments by certificate holders from that date to December 31, 1936, amounted to \$49,231,000, or an aggregate of \$59,682,000. This total may be compared with a total of \$54,472,000, representing payments of \$27,361,000 to certificate holders during the period and reserves of \$27,111,000 at December 31, 1936.¹⁰⁵ The estimated loss to certificate holders, as a whole, as so determined, was \$5,210,000,^{105a} or 8.7% of the \$59,682,000 of payments during the period plus reserves at the beginning of the period.

¹⁰⁴ Appendix P, p. 167, shows the total of reserves against outstanding certificates at January 1, 1927, and payments made by certificate holders from that date to December 31, 1936, compared with payments made to certificate holders during the same period and the total of reserves against outstanding certificates at December 31, 1936.

¹⁰⁵ This excludes figures representing equity credits to holders on account of transfers from one type of contract or certificate to another type.

^{105a} Subject to an unknown increase—probably not less than \$1,000,000—as hereinafter described.

The total amount paid to holders of certificates which matured during the period 1927-1936 was \$9,907,000,¹⁰⁶ while payments by such certificate holders amounted to \$8,117,000.¹⁰⁷ The gain thus realized by such holders was \$1,790,000. However, there were certificates which had matured during the period whose holders had elected to accept annuity payments in settlement, in the amount of \$729,000. The total of these certificates, added to the gain, brings the total gain for the period to \$2,519,000. The payments by and to matured certificate holders during the period were, by years, as follows:¹⁰⁸

Year	Aggregate amount paid to matured-certificate holders (000 omitted)	Aggregate amount paid by matured-certificate holders (000 omitted)	Payments to certificate holders as percent of payments by certificate holders
			<i>Percent</i>
1927.....	^a \$151	\$127	118.9
1928.....	242	202	119.8
1929.....	635	529	120.0
1930.....	959	728	131.7
1931.....	1,352	1,094	123.6
1932.....	1,652	1,265	130.6
1933.....	956	764	125.1
1934.....	1,440	1,031	139.7
1935.....	1,304	1,037	125.7
1936.....	^b 1,216	1,340	^b 134.2
Total.....	^a 9,907	8,117	122.1

^a Excludes \$510,000 explained above in note 106.

^b Estimated commuted value, \$583,000, of matured certificates in force would raise amount to \$1,799,000; this amount is related to the amount paid to derive the percentage.

The corresponding amounts by years, shown in the above table, while not entirely applicable to each other, represent reasonably fair relationships, and are the best possible comparisons from available data. To some extent, certificate holders continue their certificates under annuity option settlements. Payments to them are not made in a lump sum but over a period of years. These payments have been included in the years in which they were made. The total of such payments for the period was \$603,000, of which \$231,000 represented payments in 1936. For 1936 payments to holders of matured certificates were less than payments by such certificate holders. At December 31, 1936, exercised optional settlements against matured certificates amounted to \$958,000. All years except 1927 are affected to some extent by such settlements, the heaviest effect being in

¹⁰⁶ Excluding \$510,000 for which data on corresponding payments by certificate holders were lacking. Inclusive of this sum the total was \$10,417,000.

¹⁰⁷ Reply to the Commission's questionnaire for Fidelity Investment Association, Table 21.

¹⁰⁸ Id., Items 29 and 30.

1936. Since the funds representing unpaid balances due holders of matured certificates on an annuity basis are a part of reserve funds, they have not been included as payments to certificate holders.

The payments by all certificate holders and the payments to holders, both of matured certificates and those surrendered for cash before maturity for the period 1927-1936, are summarized in round amounts as follows:¹⁰⁹

Item	Including transfers	Excluding transfers
At Jan. 1, 1927, reserves against outstanding certificates amounted to ^a	\$10, 451, 000	\$10, 451, 000
From Jan. 1, 1927, to Dec. 31, 1936, certificate holders paid into the corporation the sum of.....	62, 524, 000	49, 231, 000
Thus the reserves at the beginning of the period and payments during the period total.....	72, 975, 000	59, 682, 000
At Dec. 31, 1936, total reserves against outstanding certificates were.....	27, 111, 000	27, 111, 000
There is, therefore, reserved a total for distribution to all certificate holders and for other utilization of.....	45, 864, 000	32, 571, 000
This amount distributes as follows:		
1. Payments to matured certificate holders (payments by them \$8,117,000).....	10, 417, 000	10, 417, 000
2. Payments to surrendered certificate holders.....	30, 237, 000	16, 944, 000
Together.....	40, 654, 000	27, 361, 000
3. Other utilization (net of loss to surrendered certificate holders, unamortized procurement and other costs and interest in reserve fund) as hereinafter described as to its several component parts under "Losses to Certificate Holders".....	5, 210, 000	5, 210, 000
Total.....	45, 864, 000	32, 571, 000

^a Subject to increase by an unknown amount—probably not less than \$1,000,000—for net unamortized procurement costs as of that date. Certain totals throughout the table would be correspondingly affected, i. e., increased.

B. Losses to Certificate Holders

While factual data are available concerning amounts paid to the Association by the holders of matured certificates, separate data are not available concerning payments by certificate holders who have surrendered their certificates for cash before maturity and the holders of certificates in force and outstanding.¹¹⁰ This is a most important phase of the subject. Therefore, to show the experience of investors who surrendered their certificates before maturity, and investors of certificates in force December 31, 1936, estimates were used, as hereinafter indicated, to determine the amounts of payments and reserves in respect of such certificate holders.

¹⁰⁹ Id., Items 29, 30, and 50.

¹¹⁰ The data which is the subject of these estimates were not prepared, because of the large expense involved, according to statements by officials of the Association. (Derived from supplementary information supplied the Commission for Fidelity Investment Association.)

The table, on the estimated basis, is shown as Appendix U, p. 173.

The results of the computations for the 10-year period may be summarized as follows:

Certificates in force December 31, 1936:

Payments, estimated, to Association by certificate holders-----	^a \$30,611,000
Deduct: Estimated unamortized selling and administrative expense absorbed by use of initial and installment payment receipts (*12%)-----	^a \$4,500,000
Less: Estimated interest included in cash surrender and other certificate reserves (*4%)-----	^a 1,000,000
	<hr/> 3,500,000

Total required cash surrender and other required certificate reserve values-----	27,111,000
--	------------

Certificates which were surrendered from January 1, 1927, to December 31, 1936:

Payments by surrendered certificate holders-----	^b \$34,247,000
Payments to surrendered certificate holders-----	30,237,000
Loss by surrendered certificate holders-----	^c 4,010,000

Certificates which were matured from January 1, 1927, to December 31, 1936:

Payments to matured certificate holders-----	\$10,417,000
Payments by matured certificate holders-----	8,117,000
Gain by matured certificate holders-----	2,300,000

^a Based on same percentage relation of total reserves, actual basis, as exists for Investors Syndicate. Factual data not available. Fidelity Investment Association stated compilation of information would be prohibitively expensive.

^b Residual of total payments after deducting amount for "in force" and matured certificates, also subject to increase by an unknown amount—probably not less than \$1,000,000—because of excess of actual installment payments over certificate reserves at January 1, 1927.

^c Does not include interest sacrifice of approximately \$2,000,000 at 3% per annum, also subject to increase by an unknown amount—probably not less than \$1,000,000—because of excess of actual installment payments over certificate reserves at January 1, 1927.

*Of \$27,111,000—round amounts.

The shrinkage of \$3,500,000 on certificates in force plus the loss of \$4,010,000 on surrendered certificates make a total shrinkage and loss of \$7,510,000.^{110a} This sum reduced by the gain of \$2,300,000 on matured certificates leaves a total shrinkage and loss on all certificates of \$5,210,000,^{110a} exclusive of interest sacrifice on surrendered certificates. The interest sacrifice at 3% per annum, compounded, on surrendered certificates, excluding exchanged certificates amounting to \$13,293,000, would approximate \$2,000,000, after giving effect to exchanges of equal amounts in respect of both payments by and to certificate holders. Therefore, the over-all loss to surrendered certificate holders aggregates \$6,010,000.^{110a}

The certificates in force at December 31, 1936, are, as to the status of certificate holders, of two general classes: One class is of certificates upon which holders had paid to the Association total installments of an amount in excess of the cash surrender values and other required certificate reserves of their certificates. Theoretically, if such certificates had been surrendered at December 31, 1936, the loss to holders would have been such excess plus the amount in required certificate reserves over cash surrender values. The other class is of certificates upon which holders had paid to the Association a sum less than the cash surrender value and other required reserves. Theoretically, if such certificate had been surrendered at December 31, 1936,

^{110a} Subject to increase by an unknown amount—probably not less than \$1,000,000—because of excess of actual installment payments over certificate reserves at January 1, 1927.

the gain to holders would have been such sum minus the excess of required reserves over cash surrender values.

The certificates which were surrendered between January 1, 1927, and December 31, 1936, were of two classes: One class was of certificates upon which holders received in surrender values amounts equal to or in excess of payments by them to the Association. The amount of such excess is unknown. The other class is of certificates upon which holders received in surrender values less than their payments to the Association. This latter class, therefore, bore the burden not only of the entire net loss of \$4,010,000, as above, but also an additional sum equal to the gain (whether \$1,000,000, \$2,000,000, or more) received by the former class.

The payments by certificate holders, payments to them, and the reserves retained may be tabulated as follows: ¹¹¹

[000 omitted]

Item	Payments by certifi- cate holders	Payments to certifi- cate holders ^a	Gain or (loss) to certificate holders
Terminations:			
Maturities.....	\$8, 117	\$10, 417	\$2, 300
Surrenders.....	^b 34, 247	30, 239	^b (4, 010)
Total terminations.....	^b 42, 364	40, 654	^b (1, 710)
In force Dec. 31, 1936.....	^c 30, 611	^c 27, 111	(3, 500)
Grand total.....	^b 72, 975	67, 765	^b (5, 210)

^a Includes values retained as reserves for benefit of certificate holders shown in "In force" item.

^b Subject to an unknown increase—prob bly not less than \$1,000,000—hereinbefore described.

^c Total reserves, Dec. 31, 1936, \$27,111,000, exclusive of unrequired reserves.

C. Lapsed and Surrendered Certificates

The certificates of the Association have a so-called "redate" privilege, i. e., a provision whereby for a stated period after the issuance of the certificate it may be given a new issuance date after it falls into arrears and any payments under it by the holder credited on the redated certificate which is for all practical purposes a new one.¹¹² Some of the certificates extend the privilege perpetually; others, more recent, extend it for 10 years.¹¹³ But since a payment every 10 years is sufficient to redate the certificate, the effect of the provision is also practically perpetual.¹¹⁴

A tabulation of annual terminations or exits of certificates for the years 1927 to 1936,¹¹⁵ shows that the cumulative percentage for

¹¹¹ Includes values retained as reserve for benefit of certificate holders shown in "In force" item.

¹¹² Reply to the Commission's questionnaire for Fidelity Investment Association, Item 22. See also Public Examination, Fidelity Investment Association, at 21625, et seq.

¹¹³ Ibid.

¹¹⁴ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 22. The certificates which have the 10-year redate privilege are: Income Reserve Contract, Series B, and subsequent series. Other certificates have the privilege in perpetuity except 4 series which were not offered after 1919 and the special annuity contract series which was first offered in 1925.

¹¹⁵ Appendix Q, p. 168, sets forth this tabulation in full.

lapses ¹¹⁶ and surrenders of total terminations varied from a low of 91.38% in 1930 to a high of 93.14% in 1933 (excluding the abnormal year 1928 which is discussed below). In other words—considering all certificates outstanding at any time during the period 1927–1936, and taking them by years—from 91.38% to 93.14% of all terminations represented lapses or premature surrenders, leaving only from 6.86% to 8.62% of total terminations to be accounted for by terminations as the result of normal maturity. The total terminations or exits, excluding transfers from certificates of one series to certificates of another series, represented by (1) matured certificates and (2) by lapsed and surrendered certificates were as follows:

Year	Classified total terminations			Terminations to cumulative maturity amount at beginning of period and writings during period less interim exits		
	Matured certificates (percent)	Lapsed and surrendered certificates ^a (percent)	Total (percent)	Maturities (percent)	Lapses and surrenders ^a (percent)	Lapses and surrenders times maturities ^a (times)
1928.....	5.39	94.61	100	^b 0.40	6.94	17.4
1929.....	7.57	92.43	100	.78	9.49	12.2
1930.....	8.62	91.38	100	1.09	11.60	10.6
1931.....	8.36	91.64	100	1.45	15.89	11.0
1932.....	7.65	92.35	100	1.90	22.97	12.1
1933.....	6.86	93.14	100	2.15	29.13	13.5
1934.....	6.87	93.13	100	2.44	33.95	13.9
1935.....	7.23	92.77	100	2.74	35.15	12.8
1936.....	8.00	92.00	100	3.06	35.20	11.5

^a Lapses were limited to 4 contracts and were negligible in amount.

^b The comparatively small ratios shown in the early years, in the second grouping in the above table, result from having to relate, in the computation, a large "in force" maturity amount at the beginning of the period only to effects occurring subsequently, there being available no cumulative data for amounts of certificates written, terminations, etc., prior to Jan. 1, 1927, the beginning of the period.

The total maturity amount of certificates in force and outstanding at the beginning of the period, \$87,527,000, rose steadily during the period to a total of \$247,062,000 at December 31, 1936.¹¹⁷ In such a trend the ratio of maturities to the amount of certificates issued would not keep pace with lapses and surrenders; nor would the ratio of lapses and surrenders keep constant with the amount of certificates issued. The ratio of maturities and of lapses and surrenders would be subnormal, but the ratio of surrenders to maturities would be high—abnormal. If annual sales data, with lapses, surrenders, and maturities against such particular sales, were available, and extended back for each year for the full maturity terms of affected certificates, there would result, as a reasonable certainty, higher percentages for maturities than those shown above.

It is significant that certificates which matured during the 10-year period equaled only 14% of the amount of certificates in force at the beginning of the period. Thus, the minimum ratio of surrenders to total terminations is indicated to be not less than 86%.

¹¹⁶ Only 4 series of contracts or certificates are so affected. See preceding paragraph.

¹¹⁷ Derived from supplementary information supplied the Commission for Fidelity Investment Association; see also Public Examination, Fidelity Investment Association, at 21636.

The Association furnished the Commission with contract persistency data relating to three series of certificates or contracts sold in Ohio,¹¹⁸ but because the sales were too recent, with a correspondingly high "in force" amount, the data were of little value in determining ratios of surrenders or other exits. In addition the statistics were on a period rather than an annual basis. The "in force" amounts shown in the data for December 31, 1935, were about 67%, 87%, and 99%, respectively, of the respective total sales amounts.

D. Losses on Surrendered Certificates for Early Years

Certificate holders suffer their heaviest capital losses in the first year after the issuance of the certificates. The loss in the first year is 66%. This is the result of the practice of deducting the entire selling expense—commissions, etc.—from payments during the first year. Table 28 shows, by years, the cumulative annual installment payments for 10½ years compared with corresponding cash surrender values; the amounts and percentages by cumulative installment payments and cash surrender values compared with cumulative amounts of savings bank deposits (with compound interest at 3%); and the comparative advantages of the latter in amount and percentage.¹¹⁹

TABLE 28.—*Comparative experience over a period of 10½ years of a certificate holder of an Income Reserve Contract, Series B, of Fidelity Investment Association and a depositor in a savings bank*

Period	Cumulative payments by certificate holder (at \$90 per annum)	Surrender value at end of year	Excess of cumulative payments over surrender value		Cumulative amount of savings bank deposits with interest at 3 percent compounded semi-annually		
			Amount	Percent	Total	Comparative advantage	
						Amount	Percent
1 year.....	\$90	\$31	\$59	66	\$91	\$60	193.5
2 years.....	180	120	60	33	186	66	55.0
3 years.....	270	212	58	21	283	71	33.5
4 years.....	360	308	52	14	383	75	24.4
5 years.....	450	408	42	9	485	77	18.9
6 years.....	540	512	28	5	592	80	15.6
7 years.....	630	620	10	2	701	81	13.1
8 years.....	720	734	(14)	(2)	815	81	11.0
9 years.....	810	860	(50)	(6)	931	71	8.3
10 years.....	900	1,000	(100)	(11)	1,051	51	5.1
10½ years.....	945	1,075	(130)	(14)	1,112	37	3.4

As shown by the table, a typical contract, Income Reserve Contract, Series B, without insurance, with a maturity settlement amount of \$1,250 (\$125 in successive annual payments) surrendered before the eighth year results in a loss to its holder. The margin of gain at the end of the eighth year is only \$14 more than the total

¹¹⁸ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 35.

¹¹⁹ Id., Item 34.

of the installments paid, or \$734 against total payments of \$720. Notable too is the fact that the comparative advantage of deposits in a savings account over like investments in certificates, in the table, ranges from 193.5% in the first year to 3.4% at the end of a period of 10½ years.

Table 29 compares Income Reserve Contract, Series B, without insurance, with United States Savings Bonds, based in each instance upon an investment by a purchaser of \$100 each year.¹²⁰

TABLE 29.—*Comparative experience over a period of 10 years of an Income Reserve Contract, Series B certificate holder of Fidelity Investment Association and the holder of a United States Savings Bond*

Year	Annual investments or installment payments (cumulative)	Comparative cumulative cash values at year-ends		Excess of United States Savings Bonds over Fidelity Investment Association certificates	Percent advantage over cumulative cash value of Fidelity's certificates
		United States Savings Bonds	Fidelity investment certificates		
First.....	\$100	\$101.33	\$35.66	\$65.67	184.2
Second.....	200	205.33	137.49	67.84	49.3
Third.....	300	312.00	243.10	68.90	28.3
Fourth.....	400	421.33	352.50	68.83	19.5
Fifth.....	500	533.33	467.41	65.92	14.1
Sixth.....	600	648.00	586.07	61.93	10.6
Seventh.....	700	765.33	710.11	55.22	7.8
Eighth.....	800	888.00	841.29	46.71	5.6
Ninth.....	900	1,016.00	984.75	31.25	3.2
Tenth.....	1,000	1,149.33	1,145.68	3.65	.3

Throughout the 10 years of the comparison, the amounts recoverable to investors at any time are in favor of the United States Savings Bonds, the percentage of advantage ranging from 184.2% in the first year to 49.3% in the second year to 0.3% in the tenth year. Significant, too, is the fact that the United States Savings Bonds, bearing interest at the rate of 2.9% compounded semi-annually, have a greater aggregate value at the end of 10 years than the investment certificates of the Association, notwithstanding the "reserve fund" provisions of the certificates requiring the appropriation of installments received, less fixed but unspecified charges for administrative and agency expenses, together with interest thereon at 4½% compounded semi-annually. The difference shown by the comparison emphasizes the high costs deducted by the Association and borne by the purchasers of the certificates.

A comparison of Income Reserve Contracts, Series B, without insurance, with annuity contracts¹²¹ issued by two legal reserve life insurance companies is shown in the table below. The annuity contracts have conditions of payment identical with those of the certificates

¹²⁰ Public Examination, Fidelity Investment Association, at 21623.

¹²¹ These contracts are simple installment investment contracts repayable in installments, i. e., as annuities.

of the Association. By years, for 10 years, the comparison is as follows:

Year	Annual investment (cumulative)	Attained cash surrender values		
		Corporation's investment certificate	Travelers Insurance Company annuity ^{a b}	New York Life Insurance Company annuity ^c
First.....	\$100	\$36	\$62	\$60
Second.....	200	137	156	153
Third.....	300	243	254	254
Fourth.....	400	353	355	356
Fifth.....	500	467	460	462
Sixth.....	600	586	568	578
Seventh.....	700	710	680	694
Eighth.....	800	841	796	812
Ninth.....	900	984	916	937
Tenth.....	1,000	1,146	1,040	1,065

^a Cash surrender values are payable only in installments and not in a lump-sum amount.

^b Best's Rate Book, 1936, p. 1339.

^c Best's Rate Book, 1936, p. 895. Amounts include 1936 dividend-scale accumulations.

The annuity contracts offered by the insurance companies have surrender values larger than those of the certificates of the Association until the fifth year. At the end of the tenth year, the certificates of the Association have surrender values larger by \$106 and \$81 than the respective so-called annuity contracts.

The following is a statement of the yields to investors on Income Reserve Contracts, Series B, both with and without insurance computed by consulting actuaries for the Association.¹²²

Mode of settlement	With insurance		Without insurance	
	Value	Yield	Value	Yield
(1) Cash surrender value at end of 126 (total) monthly installment payments.....	\$1,015	<i>Percent</i> 1.34	\$1,075	<i>Percent</i> 2.41
(2) Cash maturity value 129 months after due date of first monthly installment.....	1,030	1.55	1,090	2.56
(3) 10 annual payments, after maturity, of \$125 each.....	1,250	2.82	(^a)	3.38

^a Amount not shown.

E. Penalty Losses of Interest to Certificate Holders Through Delay in Installment Payments

The provisions of Section 12 of Income Reserve Contract, Series B, under the caption "Grace and New Contract," are as follows:¹²³

SECTION 12. Grace and new contract.—Subject to the provisions of Sections 6 and 7 hereof, either—

(Grace Period.) All past due payments with interest at six per centum per annum may be made at any time within one year following the first default in

¹²² Reply to the Commission's questionnaire for Fidelity Investment Association.

¹²³ Id., Item 22.

the making of any payment when due, provided such payment be made not later than three months after the due date of the last monthly payment required hereunder, or

(Reissue.) At any time within ten years from the beginning of the month for first monthly payment hereon, the total amount paid hereon will be credited on a new contract of the same form and amount, which will be issued in lieu hereof upon surrender of this contract and the receipt of the current monthly payment on the new contract and a reissue fee of a sum not to exceed five dollars plus (if Section 6 was in effect) one-tenth of each of the first three monthly payments which have become past due on this contract; such new contract shall mature later than this contract by a period equal to its period of delinquency.

The penalties involving loss of interest to certificate holders are not expressed but are implicit in the provisions. By the terms of the paragraph headed "Reissue" above, it would appear that in a given case where the certificate was in arrears 4 years' installments, but installments for the 4 years immediately preceding delinquency had been paid, the certificate would be eligible for reissuance as of the date of the last payment before delinquency. No allowance is apparently made, in such cases, for interest on the payments made prior to delinquency.

As of the end of 1936 installment payments were in a highly extended past due state. Apparently this condition is chronic. A typical certificate with a face amount of \$1,250 requires monthly payments aggregating \$90 per year, or \$72 per \$1,000 of maturity settlement or face amount. Resolved on this basis, installments would greatly exceed in amount, if paid as due, the payments received according to actual experience. The following table shows a comparison of payments on an estimated current basis with the actual experience basis for the period 1927-36:¹²⁴

Year	Average amount of certificates in force (000 omitted)	Estimated installment payments for year ^a (000 omitted)	Actual installment payments received (000 omitted)	Estimated past due status of installment payments	
				Amount (000 omitted)	Percent
1927.....	\$93,000	\$6,510	\$3,277	\$3,233	49.7
1928.....	107,000	7,490	3,911	3,579	47.8
1929.....	133,000	9,310	5,556	3,754	40.3
1930.....	171,000	11,970	7,113	4,857	40.6
1931.....	211,000	14,770	8,466	6,304	42.7
1932.....	234,000	16,380	8,543	7,837	47.8
1933.....	232,000	16,240	7,209	9,031	55.6
1934.....	229,000	16,030	5,718	10,312	64.3
1935.....	231,000	16,170	6,449	9,721	60.1
1936.....	240,000	16,800	6,279	10,521	62.6

^a Basis of \$70 per \$1,000 of maturity settlement amount of certificates in force.

According to the tabulation installment payments were past due in amounts ranging from 40.3% to 64.3%. This indicates that the pen-

¹²⁴ Id., Item 50, and derived from supplementary information supplied the Commission for Fidelity Investment Association.

alties existed and were suffered by certificate holders. On delinquent payments, satisfied under the provisions set out under "Grace Period" in the contracts, the holders paid interest at the rate of 6% on the full amount of delinquent installments and received interest credits at the rate of 4½%, compounded semiannually, in the applicable portion of the reserve fund. On the cure of the delinquency, under the contract provisions set out under "Reissue," the certificate holder during delinquency forfeited all interest earned by his applicable share of the reserve funds. There are no data available showing the amount of such interest losses, either of the interest payments required on delinquent payments or the interest lost on the reserve funds. It may be estimated, however, allowing for the automatic paid-up conversion conditions of the certificates¹²⁵ and taking an average interest rate of 5% that such interest losses to certificate holders have approximated \$100,000 each year from 1933 to 1936, inclusive.

These penalties have a practical effect. They help to assure the adequacy of the accretions to the reserve fund necessary to meet the Association's certificate obligations to be provided from interest on the basis of stipulated interest rates of 4%, 4½%, or 5%, as the case may be. This is also important in meeting payments from the fund against matured and surrendered contracts; also to the extent of any participation therein, as provided from time to time by certificate holders in good standing and the Association.¹²⁶

Before 1932 the earnings of the reserve fund in excess of the stipulated interest rate was the property of the holders of matured certificates and as such divided proportionately among them. Since that time, with the launching of Income Reserve Contract, Series A and subsequent series, this excess has been divided half and half between the holders of matured certificates and the Association.¹²⁷ During the period 1927-1936 distributions from this reserve fund surplus have amounted to \$590,000.¹²⁸

Since the installments paid each year are less than 50% of the installments due, a hypothetical case may be cited to illustrate the value to the reserve fund of the present system of payments. A fund, built up by payments of \$100 per year for 10 years, with interest at 4% compounded annually, will amount to \$1,249—\$1,000 in principal payments and \$249 in interest accumulations—at the end of the 10-year period. Another fund, built up by annual payments of \$50 for 20 years with interest compounded annually, will amount to \$1,548—\$1,000 in principal payments and \$548 in interest accumulations—at the end of the 20-year period. Thus the second fund, with the same total of principal payments as the first will have, because of the longer period for interest accumulation, \$299 more than the first fund. In actuality, where installments are paid promptly for the required period, all earnings are paid to the certificate holder, but where the payments are irregular, the maturity date of the contract is deferred and only part of the earnings of the reserve funds, i. e., sums earned while the certificate is not delinquent, are paid to the holder of such certificates.

¹²⁵ Described below.

¹²⁶ The amount of their participation is usually one-half each.

¹²⁷ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 22.

¹²⁸ Id., Item 50.

Section 11 of Income Reserve Contract, Series B, provides:¹²⁹

In the event of nonpayment within the grace period¹³⁰ prescribed in Section 12 hereof¹³¹ of any monthly payment after twelve monthly payments shall have been duly made, this contract shall automatically be converted into a paid-up contract in accordance with the paid-up contract schedule hereof. No paid-up contract shall participate in the surplus.

Similar conditions are found in all other certificates. The "surplus" referred to is earnings of the reserve fund in excess of those at the interest rate prescribed by the certificate. The holders of the paid-up certificates or contracts participate in the earnings at the fixed interest rate. Data supplied by the Association¹³² as to contracts outstanding indicate that the automatic conversion is not actually effected as a matter of practical operating and accounting procedure, but that in the case of any surrender of a certificate on which installments are in default for more than one year, the certificate holder is always given the benefit of conversion, even though no actual exchange of certificates takes place.

F. Limitations on Payments on Surrendered Certificates

The investment certificates of the Association have monthly cash surrender values after they first attain such values, which time varies from 10 to 12 monthly payments inclusive of initial payments. Thereafter, surrenders may be made at any month-end, at which time the value as of that date is paid without deduction to the holder.¹³³

G. Certificate Loans to Certificate Holders

Loan values are available to certificate holders on all certificates sold since April 1925. These values are variously stated in the different contracts, viz:¹³⁴

(a) Special Annuity Contract: Any multiple of \$10, not to exceed 95% of cash surrender value thereof;

(b) Income Reserve Contract, Series A and Series C: Any sum not to exceed 95% of cash surrender value; and

(c) Income Reserve Contract, Series B and Series D: Any amount, less interest, up to the cash surrender value.

The interest rates chargeable on such loans are ordinarily stated to be "not exceeding six percent per annum."

Since the loans allowable on some certificates are stated in terms of ascertainable amounts less interest, a discount basis of computing interest is implied. Therefore, 6% interest on a normal annual basis becomes 6.28% annually on the discount basis for loans of six months, subject to renewal.

¹²⁹ Reply to the Commission's questionnaire for Fidelity Investment Association.

¹³⁰ One year after default.

¹³¹ Quoted above.

¹³² Derived from supplementary information supplied the Commission for Fidelity Investment Association (Letter from the Association to the Commission, dated January 17, 1938).

¹³³ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 22.

¹³⁴ Ibid.

A comparison with savings bank deposits is thus suggested. As a general rule, deposits with such banks may be freely withdrawn and used without any interest charge. The depositor merely loses interest on that part of his principal withdrawn from the bank's custody and control. But for loans on the Association's investment certificates—i. e., withdrawals of part of the investor's principal—the cost to a holder of continuing his investment is increased by the interest charges made against such loans and often operates to reduce the surrender values beyond the reduction effected by the amount of the loan. Such a loan, continued by renewals over a substantial period and then terminated by a surrender for cash, could reduce materially the equity of such a holder to the corresponding benefit of the Association and the holders of matured certificates who would share the excess earnings of the reserve fund. This is especially true in cases where the certificate holder borrows the money and stops his payments at the same time—the actual situation in the majority of loans. To illustrate: the holder of a certificate with a surrender value of \$500 and a savings bank deposit of \$500 needs \$1,000 for a period of 2 years, at the expiration of which he can repay his certificate loan and restore his savings bank deposit. He thereupon borrows \$500 on his certificate and withdraws \$500 from his savings account. Assuming he made no further installment payments or savings bank deposits for 2 years, his status at the end of 2 years would be as follows:

(a) Certificate loan—\$500, the full surrender value borrowed, at 6%. Interest charges were thus \$30 per year or \$60 for the 2 years. The loan was repaid and the lien removed at the end of 2 years. The cost to the investor for the use of his own funds was thus \$60.

(b) Savings bank deposit—\$500 was withdrawn. There were no interest charges. The deposit was restored at the end of the 2 years. The cost to the depositor for the use of his own funds was nothing.

The total amounts of certificate loans outstanding at the end of each year from 1927 to 1936 and the percentage of such loans of total surrender values were as follows:¹³⁵

Year	Loans	Interest ^a	Loans as percent of total certificate reserves	Year	Loans	Interest ^a	Loans as percent of total certificate reserves
			Percent				Percent
1927.....	\$2,369,162	\$120,410	18.8	1932.....	\$6,162,164	\$203,077	26.0
1928.....	2,632,076	151,787	17.2	1933.....	3,950,675	265,295	17.8
1929.....	4,360,473	270,100	22.9	1934.....	2,732,544	148,634	12.1
1930.....	6,903,117	334,581	28.9	1935.....	2,548,312	82,305	10.2
1931.....	8,917,981	389,525	32.1	1936.....	2,307,957	143,018	8.0

^a On a collection (not accrual) basis.

The effect of the depression on certificate loans is apparent. During 1930 loans increased 58.3% over 1929, and in the following year, 1931, they reached their peak, showing an increase of 29.2% over

¹³⁵ Reply to the Commission's questionnaire for Fidelity Investment Association, Items 49 and 50 and derived from supplementary information supplied the Commission.

1930. In that year, 1931, certificate holders borrowed on their certificates up to 32.1% of existing reserve funds. The percentage rose constantly to 1931 and thereafter fell constantly. In 1936 the certificate loans were equivalent to only 8% of cash surrender values.

Certificate loans, paid by surrender by holders of their certificates and the application of surrender values to the payment of the loans amounted to \$3,652,868 for the period 1927-1936, or about 9% of the total certificate loans outstanding at year-ends during the period. By years, the amounts of repayments by such surrender were as follows:¹³⁶

Year	Liquidation by surrender of certificates	Year	Liquidation by surrender of certificates
1927.....	\$449,019	1932.....	\$97,292
1928.....	454,601	1933.....	1,526,272
1929.....	359,769	1934.....	580
1930.....	66,273	1935.....	None
1931.....	699,062	1936.....	None

H. Costs Per \$1 Paid to and Retained for Certificate Holders

The costs for the period was 31.2 cents for each \$1 paid to or preserved for certificate holders, as shown in the following table:¹³⁷

Surrender value of contracts Jan. 1, 1927, and subsequent payments by certificate holders (transfer or duplications of \$13,293,000 from exchanges of contracts eliminated).....	\$59,682,000
Income receipts for the 10-year period (deductions from installment payments excluded).....	13,149,000
Together.....	72,831,000
Distribution to and retained value for certificate holders (eliminating the above \$13,293,000 duplication):	
Distribution.....	\$27,361,000
Reserves (retained).....	27,111,000
	54,472,000
Balance, or excess of surrender value, at Jan. 1, 1927, and subsequent payments by certificate holders to Dec. 31, 1936, and income as above, over amount of distribution to and values retained for certificate holders.....	18,359,000
Deduct: Net profit, as stated, for the period.....	1,347,000
Total cost for period.....	17,012,000
Percentage cost to each \$1 of payment to and values retained for contract holders.....	31.2%

¹³⁶ Derived from supplementary information supplied the Commission for Fidelity Investment Association.

¹³⁷ Reply to the Commission's questionnaire for Fidelity Investment Association, Item 50.

I. Net Asset Margin of Safety Applicable to Cash Surrender Value of Outstanding Certificates

The amount of net assets, without deductions for certificate liabilities, and the total amount of certificate reserve, at each year-end from 1927 to 1936, together with the margins of difference between the two amounts, are given in Table 30.¹³⁸

TABLE 30.—*Margin of net assets of Fidelity Investment Association over certificate reserve funds, at year-ends, 1927–36*

Year-end	Net assets— book value (000 omitted)	Certificate reserves (000 omitted) ^a	Margin of assets over reserves	
			Amount (000 omitted)	Percent
1927.....	\$13, 370	\$12, 559	\$811	6. 5
1928.....	16, 189	15, 290	899	5. 9
1929.....	20, 142	19, 008	1, 134	6. 0
1930.....	25, 047	23, 905	1, 142	4. 8
1931.....	29, 152	27, 753	1, 399	5. 0
1932.....	25, 248	23, 671	1, 577	6. 7
1933.....	23, 826	22, 172	1, 654	7. 5
1934.....	24, 124	22, 604	1, 520	6. 7
1935.....	26, 762	24, 974	1, 788	7. 2
1936.....	30, 852	28, 702	2, 150	7. 5

^a Includes varying amounts for unrequired reserves. For 1936, the amount was \$1,591,000.

The lowest margin of assets over reserves, i. e., over certificate liability, was in 1930. It was below 6% in two other years—1931, 5.0%; 1928, 5.9%. The margin was practically constant at about 7.5% for the years 1933, 1935, and 1936. In 1934 and 1932 the margin was 6.7%. The increase in the margin for the 4-year period 1933–1936 is largely due to the sale of preferred stock,¹³⁹ principally to certificate holders, in the total amount of \$505,100 in 1931 and 1932.

¹³⁸ Ibid.

¹³⁹ See discussion *supra*, Sec. IV, *Sale of the Securities of the Corporation*, p. 84

CHAPTER FOUR

UNITED SECURITIES COMPANY OF MISSOURI

United Securities Company of Missouri is the only other sizable corporation (other than Investors Syndicate and Fidelity Investment Association) which, so far as available information indicates, offers the face amount installment certificate or contract to the public.¹

United Securities Company of Missouri was incorporated under the general corporation statutes of Missouri on October 29, 1923, for a period of 50 years.² Its charter contained broad powers, principally to engage in financial operations.³

The company has been in the business of selling its face amount certificates and investing the proceeds thereof since its organization. The principal assets of the company have consisted of real estate and obligations secured by real estate.⁴

The capital stock of the company is privately held, the securities offered to the public consisting of the face amount certificates and certain installment investment contracts which do not have a face amount.⁵

¹ Another corporation which is engaged in the business of selling face amount installment certificates is Central Acceptance Corporation of Cincinnati, Ohio, which had total assets of \$3,188,774 as of June 30, 1938. Only a small part of these assets represented payments by holders of the face amount certificates of the Corporation. Only 775 of the certificates of this Corporation, representing a total face amount of \$996,000 were outstanding at June 30, 1938. Because of these facts no detailed analysis was made of this company in connection with the Investment Trust Study.

There are doubtless other companies of this type, probably representing a purely local distribution of certificates and a very small fraction of the assets of all such companies. Even the total assets and the total investment by the public in United Securities Company of Missouri represent a very small fraction of the total assets of and the total public investment in Investors Syndicate and Fidelity Association. (See p. 2, note 4, *supra*.)

² Reply to the Commission's questionnaire for United Securities Company of Missouri, Item 1. The original name of the corporation was United Securities Company. The present name was substituted by charter amendment July 18, 1929. (*Ibid.*)

³ *Ibid.*

⁴ *Id.* Item 6.

⁵ Reply to the Commission's questionnaire for United Securities Company of Missouri, Item 22. The installment investment contract, also sometimes called "thrift plan," may be distinguished from the face amount installment contract, which is the subject of the instant report, in several ways: (1) The thrift certificate involves no obligation to pay a specified sum or sums at a specified future date or dates while the face amount certificate does. (2) The thrift certificate is issued under the terms of an indenture or quasi-trust instrument against specified property in the hands of a trustee, custodian, or depository named in the instrument, which instrument also prescribes the terms of the investment contract. The corporation is the issuer of the face amount certificate. (3) In the thrift plan the assets of the plan and assets of the sponsor are separate funds, while the assets contributed by investors in face amount contracts are part of the corporation's assets. (4) In the thrift plan the liability on the certificates is solely

The company has issued eight series of face amount certificates.⁶ The designations of such certificates and the maturity amounts and cash surrender values thereof at December 31, 1936, were as follows:⁷

Certificates	Maturity amount	Surrender or repurchase value
Series A.....	\$1,096,500.00	\$197,227.24
Series B.....	5,650.00	
Series F.....	10,352,500.00	831,087.54
Series G.....	4,137,000.00	102,506.04
Series H.....	1,674,000.00	107,479.47
Series K.....	118,500.00	4,906.00
Series L.....	11,410,050.00	191,148.96
Paid-up series.....	16,897.84	17,000.00
Total.....	28,811,097.84	1,451,355.25

Some information was submitted to the Commission as to Series "F," Series "H," Series "L" (original Series), and Series "L" (new Series).⁸

Series "F," which was offered up to and including November 10, 1931, consisted of an installment certificate and a single payment certificate, Series "H," offered up to and including July 1, 1933, included an installment certificate only. Series "L" (original series) consisted of an installment certificate and a prepaid certificate. Series "L" (new series) consisted of an installment certificate, issued under the terms of a collateral trust agreement for a 10-year maturity period and a similar certificate for a 15-year maturity period.⁹ Table 31 shows the cash surrender values of these various certificates.¹⁰

the liability of the specified corpus or fund, while in the face amount company the liability is the issuing company's. There are numerous minor differences.

The installment or thrift certificates are the subject of a special supplemental report of the Commission prepared as part of its study on investment trusts and investment companies. See the Commission's Supplemental Report on Companies Sponsoring Installment Investment Plans.

⁶ Reply to the Commission's questionnaire for United Trust Fund Certificates, Exhibit B-2.

⁷ Ibid.

⁸ Reply to the Commission's questionnaire for United Securities Company of Missouri, Item 22.

⁹ Ibid.

¹⁰ Ibid.

TABLE 31.—*Cash surrender values of installment certificates issued by United Securities Company of Missouri*

Period	Series F		Series H	Series L (original series)		Series L (new series)	
	Installment certificates ^a	Single payment certificates ^b	Prepaid certificates ^c	Installment certificates ^d	Prepaid certificates ^e	10-year certificates ^f	15-year certificates ^g
Up to 18 months.....		\$530.00	\$530.00				
18 months.....	\$38.50	543.00	543.00	\$44.00	\$600.00	\$49.00	\$50.00
2 years.....	78.00	584.00	585.00	86.00	610.00	92.00	98.00
3 years.....	160.00	615.00	620.00	170.00	650.00	179.00	196.00
4 years.....	247.00	649.00	650.00	260.00	680.00	272.00	303.00
5 years.....	339.00	687.00	687.00	380.00	710.00	395.00	422.00
6 years.....	450.00	729.00	729.00	478.00	750.00	480.00	542.90
7 years.....	567.00	777.00	777.00	590.00	800.00	600.00	664.00
8 years.....	690.00	825.00	825.00	720.00	848.00	727.00	796.00
9 years.....	818.00	877.00	877.00	848.00	900.00	862.00	943.00
10 years.....	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,115.00
11 years.....							1,252.00
12 years.....							1,434.00
13 years.....							1,616.00
14 years.....							1,818.00
15 years.....							2,000.00

^a Based on installments of \$6.30 monthly, \$18.85 quarterly, \$37.50 semiannually, or \$75 annually.

^b Based on an initial payment of \$599. (Amount not given in the reply to the Commission's questionnaire. Assumed to be the same as series L, as cash surrender values are practically identical.)

^c Based on an initial payment of a lump sum of \$599 or in 10 monthly installments of \$62 each.

^d Based on installment payments of \$7.70 monthly, \$22.75 quarterly, or \$45 semiannually.

^e Based on an initial payment of \$640.

^f Based on installment payments of \$7 monthly, \$20.70 quarterly, \$40.60 semiannually, or \$79 annually.

^g Based on installment payments of \$8 monthly, \$23.60 quarterly, \$46 semiannually, and \$90 annually.

The face amount certificates have been sold in 13 states in addition to Missouri, the state of the company's domicile. The following table shows the name of each state, the name of the officer or agency with whom the company registered under local laws, the date of the application for such registration, the effective date of such registration and the amount of deposits required by such states to secure certificate liability: ¹¹

State	Name of state agency or officer	Application date	Effective date of first qualification	Amount of deposits required
Alabama.....	Attorney general.....	Feb. 15, 1936.....	Feb. 16, 1936.....	None.
Arkansas.....	Bank commissioner.....	Feb. 17, 1936.....	Feb. 17, 1936.....	Do.
Georgia.....	Secretary of state.....	Nov. 2, 1935.....	Nov. 2, 1935.....	Do.
Illinois.....	do.....	1928.....	1928.....	100 percent of certificate liability
Indiana.....	do.....	Oct. 22, 1934.....	Oct. 22, 1934.....	None.
Kansas.....	Corporation commission.....	Sept. 9, 1935.....		Do.
Michigan.....	Secretary of state.....	July 17, 1928.....	July 17, 1928.....	Do.
Minnesota.....	Banking department.....	July 14, 1936.....	July 14, 1936.....	Do.
Mississippi.....	Secretary of state.....	July 8, 1928.....	July 8, 1928.....	Do.
Missouri.....	do.....	1926.....	1926.....	Do.
South Carolina.....	Insurance commissioner.....	May 1, 1928.....	May 1, 1928.....	Do.
Tennessee.....	Department of banking.....	July 27, 1928.....	July 27, 1928.....	Do.
Texas.....	Secretary of state.....	1928.....	1928.....	
Washington.....	Department of license.....	Apr. 14, 1936.....		Do.

¹¹ Id., Table 16.

State officials apparently do not require deposits to secure certificate liability because the face amount certificates of this company are collaterally secured under trust agreements and are in effect collateral trust certificates.¹²

¹² The legal effect of a pledge of collateral under trust agreements securing debt is different from the legal effect of a deposit of securities and the issuance of certificates of participation. In the collateral trust, face amount certificate, the securities are pledged merely to secure the company's obligation, and the company has a contingent right in the securities so deposited and their earnings, so long as its obligations are discharged. In the deposit of securities under the thrift or investment plan the company has no right in such property, legal title being in the trustee and the beneficial interest in the certificate holders exclusively. Thus, the property pledged to secure the company's obligations are part of the company's assets and so reflected in the company's balance sheet. On the other hand, the company ordinarily has no claim upon the property deposited under "investment plans" when participation certificates are issued and no obligation under the certificates; as a consequence, such property is not a part of the corporation's assets and reference to such property does not appear on the company's balance sheet.

CHAPTER FIVE

GOVERNMENTAL REGULATION

The foregoing discussion of the nature, operations, abuses and potential abuses in connection with the face amount installment investment certificates would not be complete without some reference to the regulatory laws to which companies selling this type of certificate are now subject. This chapter is devoted to a brief summary of these laws. It is important to note that, while these companies are essentially moneyed corporations, the regulation of which would seem to present problems in many respects comparable to the regulation of other types of moneyed corporations such as insurance companies and banks, existing state and federal regulation does not remotely approach the regulation imposed upon banks and insurance companies.

I. STATE REGULATION ¹

State legislation applicable to the activities of the instant type of company falls into two classes: Blue-Sky laws, which are statutes regulating the sale of securities generally; and special laws, which are statutes applicable to this particular type of company.

A. Blue-Sky Laws

The State Blue-Sky laws are of several types: securities registration statutes, fraud statutes, and dealers' statutes.

1. SECURITIES REGISTRATION STATUTES

In many states where these companies sold their certificates, the only regulation which was applied to them was through securities registration statutes. Such a statute requires every security which is to be offered for sale within the state to be registered with a designated agency before it may be offered. A typical statute of this kind requires the applicant to file certain information with the application for registration of the security, and, based on the information filed, the enforcement agency will grant or deny the application for registration. The information required includes such matters as a description of the method of doing business, copies of contracts, charters, financial statements and other documents which might be relevant to a decision on the application. Most of these states re-

¹ A description of the various state regulatory statutes, as they are applicable to Investors Syndicate, will be found in Appendix W, p. 179. This study was made to illustrate the type of regulation rather than to treat the subject comprehensively.

quire the registration of specific securities, and many of them require registration to be in specified amounts. The great majority of these states also require the agents or salesmen of the company to be registered with the enforcement agency. This type of statute is applicable, of course, not only to companies issuing face amount certificates but also to all types of corporations which sell their securities within the state.

2. DEALERS' LAWS

A minority of states require companies engaged in selling face amount certificates to register under dealers' laws, that is, laws requiring any person actually in the business of offering securities for sale within the state, whether issued by such persons or otherwise, to register as a dealer. The information required of such applicants relates primarily to the financial position of the registrant, its method of doing business, the personal history of the individuals identified with the applicant, and such matters. In the case of companies selling their own securities which are required to register as dealers, these laws operate in a way similar in some respects with the securities registration laws. Most of the statutes require periodic reports, the purpose of which is to keep information contained in the original application on a current basis. Frequently, a bond or deposit is required under these statutes either as a qualifying deposit or to secure the company's liabilities in those states.

3. FRAUD LAWS

In a few of the states, the companies issuing face amount installment certificates operate under fraud acts. These acts usually require no preliminary registration either of the dealer, the security offered, or the issuer of the security offered. Under these statutes, however, if the enforcement agency, which is usually the attorney general of the state, has reason to believe that the securities are offered by fraudulent means, he may investigate the company or the persons who have sold the securities, and if fraudulent means have been in fact used, may enjoin the further sale of the securities and frequently may institute criminal proceedings in certain circumstances.

It must be noted in connection with these several types of statutes which seek to govern primarily the sale of securities, that the instant companies are not subjected to regulations in any wise different from those applicable to any ordinary issuer. Frequently it has been found that the facilities of the enforcement agencies are inadequate to undertake the task of supervising these companies even if the agencies deemed such supervision necessary, because of the size and intricacy of the company's operations. Also, various of these corporations have succeeded in circumventing orders and denials of applications for registration either because the applicable statute did not meet the judicial test of validity or because the way in which the statute was administered did not receive the sanction of the courts upon application by the companies.²

² See Appendix W, p. 179.

B. Special Acts

In a number of states the face amount companies are brought within the purview of special legislative acts which have particular application to companies of this type.³ These special acts appear to represent a legislative effort to supply regulation to these particular companies because of the inadequacy of existing laws. The special act in the State of Maryland may be cited as an example. Under a statute commonly called the Investment Contracts Law, passed in 1931, companies offering face amount certificates in the State of Maryland are required to apply to the Insurance Commissioner of the state for authority to do business. Various exhibits, including the charter, by-laws, and financial data are required to accompany the application, together with a power of attorney from the corporation appointing the Insurance Commissioner as agent to accept service of process for the corporation. The Commissioner is authorized to examine the company's affairs, to determine if its business is in the public interest, and may at any time require an examination to the same end. The Commissioner is required to make a complete examination at least once during his term of office.⁴ The Commissioner may revoke the corporation's license for insolvency or for violation of the so-called standards. A deposit of at least \$25,000, and in no case less than the aggregate contract liability of the corporation within the state, must be maintained on deposit in a financial institution approved by the Commissioner.⁵

These special acts, being in most cases especially aimed at face amount companies, furnish a greater degree of regulation than is found under the general Blue-Sky laws. However, there is no supervision by any state over these companies of a type applicable to life-insurance companies or banks. E. E. Crabb, vice president of Investors Syndicate, testified concerning state regulation of that company:⁶

Q. In other words, aside from half a dozen states or so, the departments of insurance of the various states do not exercise jurisdiction over you?

A. That is right.

Q. And except for Iowa and New York there are no provisions in the statutes in the various states which prescribe the terms of your contract?

A. I believe that is correct, with this exception, that in practically all states the law provides that the contracts issued shall be fair, just, and equitable.

The basis of this special regulation rests on three main provisions: the right to require pertinent information; the right to conduct an examination of the corporation's affairs, including the right to compel the production of books, documents, and other data; and the require-

³ In some states, the companies are registered under Blue-Sky laws of one type or another as well as the special laws.

⁴ This right given to enforcement agencies in some of the states, to go to the home offices or other offices of a foreign corporation doing business in that state and make an examination of the corporation's books, usually is accomplished by having the applicant corporation stipulate to permit such an examination as a condition precedent to qualification to do business as a foreign corporation in that state.

⁵ A further discussion of deposit requirements will be found below.

⁶ Public Examination, Investors Syndicate, at 21554.

ment of a deposit to secure certificate liability. The first two of these powers must reside in any agency charged with enforcement of a regulatory statute if the regulation is to be effective. Without a substantial amount of exact information relating to a company, an administrative agency is severely handicapped. It has been found, however, that the full possession of material facts unaccompanied by adequate auxiliary powers to act on such data, is of little value and that frequently administrative obstacles may prevent the full and proper exercise of powers actually possessed. A deposit requirement appears to indicate a high degree of safety for investors. There are several reasons, however, indicated below why this safety is more apparent than real.

C. Deposit Requirements

One of the requirements of various of the state statutes, either Blue-Sky laws or special statutes, is that providing for a deposit, either with state officials or in institutions approved by state officials, of cash and securities as collateral security for the performance of the company's obligations. Table 32 shows the requirements of various of the states where Investors Syndicate and Fidelity Investment Association carried on business at the end of 1937.

TABLE 32.—*State requirements with respect to collateral deposits for companies issuing face amount installment certificates, December 31, 1937*

Name of States	Basis	Nature
Alabama.....	Liability plus 10 percent.....	Bonds and mortgages.
California.....	do.....	Do.
Connecticut.....	do.....	Do.
Florida.....	Fixed amount.....	Mortgages.
Georgia.....	Liability plus 10 percent.....	Bonds and mortgages.
Illinois.....	Liability subsequent to July 7, 1931.....	Bonds.
Iowa.....	Liability.....	Bonds and mortgages.
Kansas.....	Liability plus 10 percent.....	Do.
Louisiana.....	do.....	Mortgages.
Maryland.....	do.....	Bonds and mortgages.
Massachusetts.....	do.....	Do.
Michigan.....	do.....	Mortgages.
Minnesota.....	Fixed amount.....	Do.
Missouri.....	Liability plus 10 percent.....	Bonds and mortgages.
Nebraska.....	do.....	Mortgages.
Nevada.....	One-tenth of liability plus 10 percent.....	Do.
New Jersey.....	Fixed amount.....	Bonds.
New York.....	Equal to undivided interest of subscribers.....	Mortgages.
North Carolina.....	Liability plus 10 percent.....	Bonds and mortgages.
North Dakota.....	do.....	Do.
Oregon.....	do.....	Do.
Ohio.....	Fixed amount.....	Do.
Pennsylvania.....	do.....	Bonds.
South Dakota.....	Liability plus 10 percent.....	Bonds and mortgages.
Tennessee.....	do.....	Do.
Texas.....	Withdrawal value under permit subsequent to May 20, 1931.....	Do.
Utah.....	Liability plus 10 percent.....	Do.
Virginia.....	Fixed amount.....	Bonds.
Washington.....	Liability plus 10 percent subsequent to Apr. 21, 1930.....	Bonds and mortgages.
West Virginia.....	Liability plus \$100,000.....	Do.
Wyoming.....	Fixed amount.....	Mortgages.

Tables 33 and 34 show the amounts on deposit and the liability of the respective companies on certificates outstanding as of December 31, 1937.⁷

TABLE 33.—*Amount of deposits and cash surrender value of certificates outstanding of Investors Syndicate, by States, December 31, 1937*

Investors Syndicate

State	Amount of deposit °	Cash surrender value of certificates outstanding	State	Amount of deposit °	Cash surrender value of certificates outstanding
Alabama.....	\$2, 574, 359. 48	\$2, 206, 996. 96	New York.....	\$4, 357, 675. 58	\$4, 039, 017. 08
California.....	5, 266, 212. 34	4, 659, 471. 50	North Carolina.....	1, 660, 281. 26	1, 427, 228. 51
Colorado.....	25, 066. 47	1, 689, 142. 45	North Dakota.....	1, 785, 129. 00	1, 579, 933. 90
Connecticut.....	3, 655, 947. 62	3, 043, 956. 81	Ohio.....	100, 265. 87	206, 489. 28
Florida.....	147, 068. 86	1, 042, 579. 06	Oregon.....	691, 454. 96	581, 782. 38
Georgia.....	1, 592, 955. 18	1, 378, 212. 25	Pennsylvania.....	100, 265. 87	1, 918, 522. 08
Illinois.....	1, 175, 394. 19	1, 355, 142. 83	South Dakota.....	2, 089, 240. 97	1, 766, 230. 48
Iowa.....	2, 585, 940. 26	2, 035, 911. 58	Tennessee.....	2, 743, 769. 41	2, 484, 382. 19
Kansas.....	4, 649, 612. 98	4, 373, 613. 31	Texas.....	1, 227, 868. 70	2, 053, 735. 56
Louisiana.....	551, 234. 44	460, 249. 06	Utah.....	1, 296, 022. 42	1, 097, 808. 80
Maryland.....	917, 982. 76	747, 359. 31	Virginia.....	100, 363. 28	1, 717, 084. 50
Massachusetts.....	2, 965, 302. 19	2, 635, 390. 83	Washington.....	983, 690. 57	865, 738. 88
Minnesota.....	125, 260. 27	7, 856, 240. 32	West Virginia.....	1, 674, 893. 48	1, 480, 497. 15
Missouri.....	2, 990, 627. 94	2, 595, 458. 01	Wyoming.....	60, 755. 07	258, 030. 42
Nebraska.....	119, 220. 17	162, 844. 19			
Nevada.....	25, 107. 02	102, 108. 36			
New Jersey.....	30, 079. 76	1, 469, 928. 48			
			Total.....	48, 269, 048. 37	59, 291, 086. 52

° Securities at book values.

The total certificate liability (i. e., cash surrender value of certificates) December 31, 1937, in those states requiring such deposits was \$59,291,086.52 against which there were deposits which, at their book values, amounted to \$48,269,048.37. At the same date the total certificate liability of the Corporation and its New York subsidiary was \$106,350,990.81.⁸

⁷ Derived from supplementary information supplied the Commission for Investors Syndicate.

⁸ Derived from supplementary information supplied the Commission for Investors Syndicate. This figure includes liability on certificates outstanding in Canada.

TABLE 34.—Amount of deposits and cash surrender liability of certificates outstanding of Fidelity Investment Association, by States, December 31, 1937

Fidelity Investment Association

State	Gross cash surrender liability	Loans, includ- ing prepaid and accrued interest	Net cash surrender liability	Securities deposited, book value
Alabama ^a	\$15,538.76	\$1,469.04	\$14,069.72	\$24,805.00
Delaware.....	328,539.09	30,300.35	298,238.74	514,900.68
Illinois ^b	5,059,184.90	383,187.56	4,675,997.34	3,029,121.68
Indiana.....	258,515.23	22,020.54	236,494.69	141,929.36
Iowa ^c	38,877.64	3,897.59	34,980.05	32,161.07
Kansas.....	82,654.48	4,150.49	78,503.99	80,237.50
Kentucky ^d	64,298.18	13,895.54	50,402.64	9,900.00
Maryland.....	715,182.65	41,134.63	674,048.02	584,213.42
Missouri.....	836,115.02	60,324.03	775,790.99	879,017.27
Ohio ^e	2,492,201.01	152,220.74	2,339,980.27	106,750.04
Pennsylvania ^f	6,477,261.38	441,169.11	6,036,092.27	107,657.50
Virginia ^g	404,564.87	23,655.47	380,909.40	24,750.00
West Virginia.....	2,912,748.59	173,346.92	2,739,401.67	21,100,126.91
Wisconsin.....	1,686,505.36	51,369.27	1,635,136.09	1,696,084.81
States in which not qualified and States in which qualified but not requiring a deposit ^h	6,652,369.11	622,660.66	6,029,708.45	-----
	28,024,556.27	2,024,801.94	25,999,754.33	28,331,655.24
Securities not deposited held by banks and in company's vaults for safekeep- ing pending disposition.....	-----	-----	-----	892,922.35
	-----	-----	-----	29,224,577.59

^a Deposit with State Treasurer of West Virginia against liability on certificates sold in Alabama. (Ibid.)^b Deposit required on certificates sold since July 7, 1931. (Ibid.)^c Deposit covers liability on Special Income Contracts and Special Annuity Contracts only. (Ibid.)^d Deposit covers liability on Income Reserve Contracts, Series D only. (Ibid.)^e Statutory deposit only; balance covered by West Virginia deposit. (Ibid.)^f Statutory deposit only; balance covered by West Virginia deposit. (Ibid.)^g Statutory deposit only; balance covered by West Virginia deposit. (Ibid.)^h Washington, D. C.; Georgia; Michigan; and Tennessee liability covered by West Virginia deposit.

For Investors Syndicate, 30 states require these deposits. Of these 30 states, 16 states have approved the Midland National Bank and Trust Company of Minneapolis as the repository of these funds. The deposits for one state, California, are kept in a local institution, the Union Bank and Trust Company of Los Angeles. The remaining 13 states require that the deposits be made directly with the appropriate state officials.⁹ It is reported by the Midland National Bank and Trust Company that the deposits are segregated by it by

⁹ Derived from supplementary information supplied the Commission for Investors Syndicate. The states which have authorized deposits in the Midland National Bank and Trust Company of Minneapolis are Alabama, Connecticut, Florida, Georgia, Kansas, Louisiana, Maryland, Massachusetts, Missouri, North Carolina, North Dakota, Oregon, South Dakota, Tennessee, Utah, and Washington. Two of these states, Kansas and North Carolina, have local institutions as co-depositaries. The 13 states which require the deposits, and the respective state officials are: Colorado, state treasurer; Illinois, secretary of state; Iowa, state auditor; Minnesota, state treasurer; Nebraska, superintendent of banks; Nevada, state treasurer; New Jersey, Commissioner of banking and insurance; Ohio, state treasurer; Pennsylvania, state treasurer; Texas, state treasurer; Virginia, an individual citizen of Virginia designated by the state; West Virginia, state treasurer; and Wyoming, secretary of state.

states and that the securities are earmarked. It does not appear, however, that independent appraisals are made of real estate or mortgages on real estate either by the bank or by the state officials.¹⁰ A specimen copy of a deposit agreement that is effective in Massachusetts will be found in Appendix V.

In the case of Fidelity Investment Association, the arrangements for deposits vary somewhat from those applicable to Investors Syndicate because of the fact that under the statute of West Virginia, the state in which the Association is incorporated, the company must deposit the amount of certificate liability for certificates outstanding irrespective of whether they are outstanding in West Virginia. If individual foreign states require deposits by their own statutes, West Virginia credits such deposits in its own deposit account so that the company does not have to make duplicate deposits for the same certificates. The deposits are said to be computed on the basis of market value. One of the allegations in the bill of complaint of the Securities and Exchange Commission against the Association, on December 14, 1938, was that the Association had failed properly to comply with these deposit requirements, and on December 22, 1938, the Association was enjoined, among other things—

from purchasing and depositing with West Virginia, or any other state, insufficient securities or securities which do not meet deposit requirements, or failing to segregate and maintain at all times sufficient statutory deposit against appropriate liabilities * * *

If the deposit requirements be viewed entirely in the light of the protection they afford certificate holders as a whole, certain basic infirmities appear in the present system of such deposits: (1) in the case of some of the companies, even if the security be assumed to be adequate to protect the specific investors they purport to protect, such investors represent only a part of all investors in such companies—thus, merely because of geographical location some of the investors would be discriminated against; (2) it may not be assumed that the security of these deposits is adequate because it does not appear affirmatively that the actual value of the assets deposited is as great as the book value; (3) it does not appear affirmatively that the deposits would in every case be held by the courts to be trust funds for the exclusive benefit of the certificate holders to whom they are applicable in the event of the insolvency of the corporation.

D. New York Regulations

In the State of New York, neither Investors Syndicate nor Fidelity Investment Association sell their certificates directly, but instead offer the certificates or contracts of subsidiaries, Investors Syndicate Title and Guaranty Company and Fidel Association of New York, Incorporated, respectively. The subsidiary company of Investors Syndicate is apparently subject to a greater degree of supervision than is the parent in other jurisdictions. It is regulated in the State of New York under a section of the insurance laws. However, in

¹⁰ Derived from supplementary information supplied the Commission for Investors Syndicate.

¹¹ See Appendix X, p. 197.

several cases the insurance authorities have sought to increase the degree of regulation in order to protect investors in that state.

II. FEDERAL REGULATION

The only federal regulatory legislation applicable to the activities of these companies is the Securities Act of 1933. The Securities Act generally requires the registration with this Commission of all securities offered, sold, or delivered after sale through the mails or in interstate commerce. Registration is effected by filing with the Commission a registration statement containing certain specified information relative to the securities being registered and the company issuing them. The Act also requires that in the sale of registered securities a prospectus be used containing a résumé in prescribed form of the information contained in the registration statement. It will be noted these provisions of the Securities Act serve only to compel the disclosure of relevant information; the Act does not authorize the Commission to approve, disapprove, or otherwise pass on the merits of securities—in fact, the Act expressly forbids representations that registration implies approval by the Commission.

The application of these registration and prospectus requirements is limited by certain provisions for exemption contained in the Securities Act, among which is Section 3 (a) (8), which exempts—

Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.

Most of the companies selling face amount installment investment certificates, and particularly Investors Syndicate and Fidelity Investment Association, have consistently maintained that their certificates fall within Section 3 (a) (8) and are consequently exempted from registration under the Act. Section 3 (a) (8) has not as yet been judicially construed, and no opinion is here expressed as to whether the companies' interpretation of the statute is or is not correct.

On May 27, 1939, Investors Syndicate, although not conceding any legal duty on its part to register under the Securities Act, filed a registration statement thereunder, covering \$150,000,000 face amount of Series H investment contracts and \$2,500,000 face amount of Series I 3% coupon certificates.¹² At present writing, the registration statement has not yet become effective, since the statutory period of twenty days has not run since the filing of the last amendment to the statement.¹³

In addition to the registration and prospectus requirements of the Securities Act to which reference has been made, Section 17 (a) of the Act prohibits the use of the mails or means or instruments of interstate commerce in the fraudulent sale of securities, and Section 12 (1) imposes civil liability for transactions of that character. The companies selling face amount installment investment certificates have

¹² Securities Act Registration Statement No. 2-4057; see Securities Act Release No. 1971.

¹³ March 1, 1940.

generally conceded that the fraud sections of the Act, as distinguished from its registration and prospectus requirements, are applicable to them. Since the certificates issued by these companies are clearly securities within the definition of the term "security" in Section 2 (1) of the Act, and since the Act expressly provides that such exemptions from registration as that provided by Section 3 (a) (8) have no application to the fraud sections, no other conclusion appears possible.

Investors Syndicate has summarized its position with respect to the Securities Act of 1933 as follows:¹⁴

Our certificates come within the provisions of Subdivision 8 of Section 3, covering exempted securities under the Federal Act. This does not mean that we are exempt from the Act, but it does mean that we are exempted from registration under the Act. We do come under Sections 12 and 17 of the Act. * * *

On December 14, 1938, a bill of complaint against the Fidelity Investment Association, together with supporting affidavits, was filed in the United States District Court for the Eastern District of Michigan by the Securities and Exchange Commission to enjoin certain alleged irregularities in the Association's operations and in the sale of the contracts or certificates.¹⁵ On December 22, 1938, the defendant, Fidelity Investment Association, filed an answer purporting to be a general denial. On the same day, however, the defendant consented to the entry of a final decree, and thereupon the Court entered a final decree, permanently enjoining the defendants from the acts complained of, and reading in part as follows.¹⁶

NOW, THEREFORE, IT IS ORDERED, ADJUDGED, AND DECREED, That the Defendant, Fidelity Investment Association, its officers, directors, agents, successors, representatives, employees, and assigns be, and they hereby are, perpetually enjoined and restrained from, in the sale of Special Income, Special Annuity, Income Reserve Series A, Income Reserve Series B, or Income Reserve Series D Contracts, or Guarantees of Fidel Association of New York, Incorporated, Collateral Trust Bonds Series A and Series B, or any other security, by the use of any means or instruments of transportation or communication in interstate commerce, or by the use of the mails, directly or indirectly—

A. 1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements; or

2. Failing to segregate and maintain at all times sufficient statutory deposits against appropriate liabilities; or

3. Failing to create and maintain separate contract reserve funds, or permitting cash over-drafts between various contract funds; or

4. Failing to maintain required reserve; or

5. Transferring to Defendant's general fund gains belonging to contract funds; or

¹⁴ This statement is contained in a letter to Stanley S. Wohl, Principal General Clerk, Securities Division, Corporation Commission, Raleigh, North Carolina, from Henry M. Isaacs, vice president and general counsel of the company, dated September 12, 1933. A carbon copy of this letter is in the complaint files of the Securities and Exchange Commission.

¹⁵ *Securities and Exchange Commission v. Fidelity Investment Association*, District Court of the United States for the Eastern District of Michigan, Southern Division, Civil Action, File No. 281.

¹⁶ See Appendix X, p. 197.

6. Transferring or selling securities from one contract fund to another contract fund, or between contract funds and the general fund; or

7. Paying dividends except from earned surplus; or

8. Purchasing securities to the personal benefit of anyone connected directly or indirectly with the Defendant; or

9. Engaging in any other similar transaction, practice, or course of business in any manner which would operate or does operate as a fraud or deceit.

B. Creating or maintaining subsidiaries to conceal the nature or amount of indebtedness or investments, or employing any other device, scheme, or artifice to defraud.

C. Obtaining money or property by means of untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, concerning—

1. The truth of financial or other statements which withhold or suppress material facts; or

2. The extent or availability of reserves or assets of Defendant or of the various contract funds; or

3. The cost of portfolio securities, the book value of which has been or is enhanced or depressed; or

4. The rating, nature or liquidity of the investments of Defendant or of the various contract funds; or

5. The yield, earnings or financial condition of Defendant or of the various contract funds; or

6. The means used by Defendant to meet contract demands or maturities; or

7. The costs attached to contract certificates issued and sold by Defendant, or their incidence; or

8. The amounts payable to or withdrawable by contract holders; or

9. The yield paid by Defendant to contract holders; or any other statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, similar to those specifically set forth above or of similar purport or object.

(S.) EDWARD J. MOINET,
United States District Judge.

Dated December 22, 1938.

A summary of this report and a statement of conclusions and recommendations with respect to companies issuing face amount installment certificates are contained in the section on Conclusions and Recommendations in the (General) Report on Investment Trusts and Investment Companies.

APPENDIXES

Companies Issuing Face Amount Installment Certificates

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APPENDIX A-1

INVESTORS SYNDICATE

General balance sheet, Dec. 31, 1936

RESOURCES

Cash-----		\$2, 418, 611. 69
This consists of actual cash in office and deposits in various banks.		
Bonds and securities:		
United States Government bonds-----	\$6, 111, 306. 88	
State, county, and municipal bonds-----	3, 082, 845. 82	
Railroad bonds-----	1, 702, 202. 16	
Public utility bonds-----	4, 001, 153. 23	
Industrial bonds-----	1, 225, 839. 60	
Canadian Government, provincial, and municipal bonds-----	1, 159, 474. 05	
Canadian corporation bonds-----	1, 337, 979. 02	
Preferred and guaranteed stocks-----	3, 505, 091. 04	
	<hr/>	22, 125, 891. 80
Federal Housing Administration Insured mortgages-----		14, 826, 034. 98
First liens on real estate (other than those insured by the Federal Hous- ing Administration)-----		34, 094, 202. 67
Mortgage loans endorsed by company-----		3, 798, 039. 58
Loans on certificates-----		3, 931, 097. 97
Real estate (at cost less depreciation)-----		5, 277, 057. 12
Stocks of wholly owned companies-----		3, 616, 238. 21
Furniture and fixtures (at cost less depreciation) carried at cost less depreciation-----		128, 747. 30
Other resources-----		673, 933. 73
		<hr/>
Total-----		90, 889, 855. 05

LIABILITIES

Certificate cash surrender values-----		65, 229, 135. 26
Contingent liability reserve-----		11, 661, 260. 28
Accrued liabilities not due-----		440, 606. 35
Other current liabilities-----		963, 060. 65
Contingent liabilities as endorsed on mortgages-----		3, 798, 039. 58
		<hr/>
Total liabilities-----		82, 092, 102. 12
Certificate reserve-----	\$6, 681, 042. 51	
Capital and surplus-----	2, 116, 710. 42	
	<hr/>	
Total capital, surplus, and reserve-----		8, 797, 752. 93
		<hr/>
Total-----		90, 889, 855. 05

APPENDIX A-2

INVESTORS SYNDICATE

*Investors Syndicate Title & Guaranty Co., New York, N. Y.—Balance sheet,
Dec. 31, 1936^a*

[Stock carried at \$567,508.58 by Investors Syndicate]

RESOURCES

Cash		\$86,476.17
Bonds:		
United States Government	\$193,304.55	
State and municipal	176,461.25	
		369,765.80
First mortgages and first-trust deeds deposited with trustee or state depository	3,924,364.75	
Less—undivided interest thereon under participation certi- ficates outstanding	3,694,603.65	
		229,761.10
First mortgages		124,569.77
Accrued interest:		
Bonds	2,191.32	
Mortgages	39,881.13	
		42,072.45
Total ^b		852,645.29

LIABILITIES

Reserve for federal and state taxes	7,824.42
Certificate and contingency reserves	37,517.46
Accounts payable and other liabilities	107,629.25
Accrued earnings on participation certificates not due	132,165.58
	285,136.71

CAPITAL AND SURPLUS

Capital stock	\$250,000.00
Fixed surplus	250,000.00
Surplus and undivided profits	67,508.58
	567,508.58
Total	852,645.29

^a From report of Banking Division, Department of Commerce, State of Minnesota, on Investors Syndicate, for the year 1936.

^b Does not include nonadmitted assets of \$17,345.54, consisting of furniture and fixtures at depreciated value of \$13,375.73 and accounts receivable of \$3,969.81.

APPENDIX A-3

INVESTORS SYNDICATE

*Consolidated financial statement of Southwestern Mortgage Investment Corp.,
Southern Mortgage Loan Co., and Jefferson Mortgage Co.^a—Dec. 31, 1936*

[Stocks carried at \$3,048,720.63 under Stocks by Investors Syndicate]

ASSETS

Due from banks:

First National Bank & Trust Co., Minneapolis:

Southwestern Mortgage Investment Corporation..... \$6,012.72

Southern Mortgage Loan Co..... 487.26

Birmingham Trust & Savings Bank, Birmingham, Ala.: Jefferson Mortgage
Co..... 428.96

Total due from banks..... 6,928.94 \$6,928.94

Accounts receivable: Jefferson Mortgage Co. (insurance premiums)..... 1,212.13

Notes receivable: Jefferson Mortgage Co..... 581.00

Furniture and fixtures:

Southwestern Mortgage Investment Corporation (net)..... 96.50

Jefferson Mortgage Co. (net)..... 1,285.74

1,382.24

1,382.24

Automobile account: Jefferson Mortgage Co. (net)..... 805.30

Location	Mortgages to Southern Mortgage Loan Co.				
	Items	Pledged with Reconstruc- tion Finance Corporation	Not pledged	Book value	
Real estate—Southwestern Mortgage In- vestment Corporation:					
Arkansas, Little Rock.....	30	\$99,650.00		\$100,457.17	
California, Los Angeles and vicinity...	30	281,200.06		286,072.20	
Georgia, Atlanta.....	14	86,400.00		76,520.14	
Michigan, Flint.....	8	43,300.00		40,604.14	
Michigan, Pontiac.....	43	186,750.00		170,185.09	
Minnesota, Minneapolis.....	4	332,500.00		347,081.04	
Minnesota, St. Paul.....	3	336,000.00		303,365.66	
Oklahoma, Oklahoma City.....	12	79,184.00		68,225.71	
Oklahoma, Tulsa.....	153	968,651.00		792,825.65	
Oregon, Portland.....	82	171,150.00	\$105,558.31	245,569.58	
Texas, Fort Worth.....	44	192,050.00		158,397.45	
Texas, Houston.....	3	20,450.00		14,009.05	
Washington, Seattle.....	12	59,150.00		67,085.29	
	438	2,856,435.00	105,558.31	2,670,398.17	
Real estate—Jefferson Mortgage Co., Alabama, Birmingham.....	781	3,247,150.00		2,308,941.26	
	1,219	6,103,585.00	105,558.31 6,103,585.00	4,979,339.43	4,979,339.43
Less payments made but not allocated to any particular loans.....		307,461.94	6,209,143.31		
Less error in paying \$4,726.54 instead of \$4,667.16 on Houston loan No. 17564.....		59.38	307,521.32		
Net liability on mortgages payable by Southwestern Mortgage Investment Corporation to Southern Mortgage Loan Co.....			5,901,621.99		
Total assets.....					4,990,249.04

^aFrom report of Banking Division, Department of Commerce, State of Minnesota, on Investors Syndicate, for the year 1936.

*Consolidated financial statement of Southwestern Mortgage Investment Corp.,
Southern Mortgage Loan Co., and Jefferson Mortgage Co.—Continued*

ASSETS—Continued

Total assets (carried forward).....		\$4,990,249.04
Less offsetting liabilities and reserves: Bills payable to Reconstruction Finance Corporation: Southern Mortgage Loan Co.....	\$1,297,169.32	
Accounts payable to Investors Syndicate:		
Southwestern Mortgage Investment Corporation.....	\$89,502.71	
Southern Mortgage Loan Co.....	1,339.59	
Jefferson Mortgage Co.....	50,390.06	
		141,232.36
Accrued interest payable: Southern Mortgage Loan Co.....		20,011.82
Reserve for depreciation:		
Southwestern Mortgage Investment Corporation.....	\$258,033.30	
Jefferson Mortgage Co.....	260,766.04	
		518,799.34
		1,977,212.84
Prepaid expense:		
Southwestern Mortgage Investment Corporation.....	9,978.96	
Jefferson Mortgage Co.....	25,705.47	
		35,684.43
		1,941,528.41
Net book value of Southwestern Mortgage Investment Corporation:		
Southern Mortgage Loan Co. and Jefferson Mortgage Co.....		3,048,720.63

SUMMARY OF CAPITAL STRUCTURE

Capital stock—Southwestern Mortgage Investment Corporation.....	\$500,000.00	
Capital stock—Southern Mortgage Loan Co.....	\$500,000.00	
Less portion owned by Southwestern Mortgage Investment Corporation.....	247,000.00	
		253,000.00
Capital—Jefferson Mortgage Co.....		3,000.00
		756,000.00
Surplus—(Equity in real estate) Southwestern Mortgage Investment Corporation.....	2,507,740.74	
Surplus—(Paid) Southern Mortgage Loan Co.....	150,000.00	
		2,657,740.74
Surplus—(Earned) Southwestern Mortgage Investment Corporation.....	^a 350,941.21	
Surplus—(Earned) Southern Mortgage Loan Co.....	37,999.43	
Surplus—(Earned) Jefferson Mortgage Co.....	^a 52,078.33	
		^a 365,020.11
Total.....		3,048,720.63

Net book value.—Stock of Southwestern Mortgage Investment Corporation, Southern Mortgage Loan Co. and Jefferson Mortgage Co.

^a From report of Banking Division, Department of Commerce, State of Minnesota, on Investors Syndicate, for the year 1936.

APPENDIX A-4

INVESTORS SYNDICATE

Consolidated comparative balance sheet ^a as at Dec. 31, 1936 and Dec. 31, 1935

Account, etc.	Dec. 31, 1936	Dec. 31, 1935
Resources:		
Cash on hand and in banks	\$2, 531, 178. 13	\$4, 052, 908. 34
Bonds and securities (market \$23,627,362.23)	22, 713, 952. 20	25, 606, 666. 29
F. H. A. mortgages (U. S. Government guaranteed) (market, \$15,122,- 554.68)	14, 826, 034. 98	0
First liens on real estate	38, 143, 898. 32	29, 770, 672. 14
Certificate loans	3, 931, 097. 97	3, 373, 870. 05
Real estate	9, 776, 717. 21	12, 728, 131. 54
Furniture and fixtures (depreciated cost)	144, 933. 66	131, 992. 08
Other assets	531, 537. 12	497, 716. 02
Total resources	92, 599, 349. 59	76, 161, 856. 46
Liabilities:		
Certificate cash surrender values	68, 923, 738. 91	55, 029, 851. 53
Certificate contingent liability	11, 661, 260. 28	9, 109, 183. 63
Accrued earnings on participation certificates not due	6, 681, 042. 51	6, 460, 429. 41
Other accrued liabilities not due	518, 841. 86	191, 298. 00
Note payable (R. F. C. loan subsidiary)	1, 317, 181. 14	2, 923, 471. 02
Other current liabilities	1, 205, 477. 61	614, 978. 86
Capital and surplus consolidated	2, 291, 807. 28	1, 832, 644. 01
Total liabilities and capital	92, 599, 349. 59	76, 161, 856. 46
Hidden or secret reserves:		
Excess of market value of bonds and securities over book value Dec. 31, 1936	913, 409. 03	-----
Excess of market value of F. H. A. mortgages over book value Dec. 31, 1936	296, 520. 70	-----
Nonadmitted assets—New York subsidiary furniture, autos and ac- counts receivable	17, 345. 54	-----
Excess of mortgage cost over book value shown above—charge off re- serve	112, 850. 00	-----
Second mortgages on real estate sold	60, 367. 51	-----
Excess of real estate cost over book value—Dec. 31, 1936—depreciation reserve	844, 712. 63	-----
Total	2, 245, 205. 41	-----

^a From certified public accountant's report to Superintendent of Insurance, State of Ohio, dated January 29, 1937.

APPENDIX B INVESTORS SYNDICATE

Main classifications of income and expenses and average certificate obligations and related ratios, 1927-36

[Amounts in thousands of dollars]

Particulars	Years										Pct.
	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	
Income:											
Initial payment receipts.....	(a)	(a)	4,274	4,276	3,540	2,687	1,998	2,060	2,958	3,753	25,546
Other income, as interest, dividends, etc.....	1,163	1,518	2,113	2,510	2,986	3,100	2,853	3,431	4,122	5,708	29,504
Total.....	1,163	1,518	6,387	6,786	6,526	5,787	4,851	5,491	7,080	9,461	55,050
Expenses:											
Net appropriations to reserves and other certificate interest—miscellaneous	688	676	2,078	2,956	3,017	1,879	1,920	2,519	3,164	4,211	23,108
Commissions paid.....	(a)	(a)	2,869	2,426	1,908	1,833	1,328	1,589	2,253	2,730	16,936
Other expenses, as salaries and other operation costs.....	369	641	843	1,236	1,316	2,008	1,943	1,363	1,405	1,830	12,954
Total.....	1,057	1,347	5,790	6,618	6,241	5,720	5,191	5,471	6,822	8,771	52,998
Net income:											
Initial payment receipts less net appropriations to reserves (and other certificate interest—miscellaneous) and commission paid.....	(688)	(676)	(673)	(1,106)	(1,385)	(1,025)	(1,250)	(2,048)	(2,459)	(3,188)	(14,498)
Other—net of other income less other expenses.....	794	877	1,270	1,274	1,670	1,092	910	2,068	2,717	3,878	16,550
Total.....	106	201	597	168	285	67	(340)	20	258	690	2,052
Certificate obligations, average for year.....	\$16,578	\$20,606	\$26,525	\$33,300	\$40,431	\$45,882	\$49,212	\$54,179	\$62,672	\$75,642	\$425,027
Percent of net appropriations to reserves (including other certificate interest) (interest service to certificate obligations).....	4.15%	3.28%	7.83%	8.88%	7.46%	4.10%	3.90%	4.65%	5.05%	5.57%	5.44%

Percent of "other" net income, i. e., net income from investment operations available for interest service to certificate obligations (does not include initial payment receipts nor commissions paid)-----

Asset margin of safety:

Net assets at end of year ^c-----
Certificate cash surrender values at end of year-----
Amount of margin-----
Percent of margin-----

4.79%	4.26%	4.79%	3.83%	4.13%	2.38%	1.85%	3.82%	4.34%	^d 5.13%	3.89%
\$15,909	\$24,300	\$31,051	\$38,194	\$45,565	\$49,141	\$52,434	\$59,005	\$69,395	\$85,688	-----
\$17,962	\$23,250	\$29,799	\$36,800	\$44,063	\$47,701	\$50,725	\$57,634	\$67,713	\$83,572	-----
\$947	\$1,050	\$1,252	\$1,394	\$1,502	\$1,440	\$1,709	\$1,371	\$1,682	\$2,116	-----
5.3%	4.5%	4.0%	3.6%	3.4%	3.0%	3.4%	2.4%	2.5%	2.5%	-----

^a Not shown.

^b Includes other certificate interest which relates to coupon interest or coupon certificates and miscellaneous. Other certificate interest, as for advances, etc.: 1929, \$81; 1930, \$269; 1931, \$293; 1932, \$348; 1933, \$404; 1934, \$380; 1935, \$387; 1936, \$619; period \$2,781.

^c Before deduction for certificate liabilities.

^d 0.98 percent from profit on sales of securities. profit the percentage would be 3.54 percent.

Without this more or less nonrecurring

APPENDIX C

INVESTORS SYNDICATE

Payments by certificate holders and, separately, payments to matured certificate holders and payments to surrendered certificate holders, 1927-36

[Amounts in thousands of dollars]

Particulars	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	Period
Certificate obligations at beginning-----	15, 193	17, 962	23, 250	29, 799	36, 800	44, 063	47, 701	50, 725	57, 634	67, 713	15, 193
Payments by certificate holders-----	5, 604	7, 561	10, 467	13, 104	14, 347	12, 775	11, 890	14, 695	19, 250	24, 022	133, 715
Together-----	20, 797	25, 523	33, 717	42, 903	51, 147	56, 838	59, 591	65, 420	76, 884	91, 735	148, 908
Initial payment receipts-----	(^a)	(^a)	4, 274	4, 276	3, 540	2, 687	1, 999	2, 060	2, 958	3, 753	25, 547
Balance-----	20, 797	25, 523	29, 443	38, 627	47, 607	54, 151	57, 592	63, 360	73, 926	87, 982	123, 361
Net appropriations to reserves-----	688	676	1, 997	2, 687	2, 724	1, 531	1, 516	2, 139	2, 777	3, 592	20, 327
Together-----	21, 485	26, 199	31, 440	41, 314	50, 331	55, 682	59, 108	65, 499	76, 703	91, 574	143, 688
Certificate obligations at end-----	17, 962	23, 250	29, 799	36, 800	44, 063	47, 701	50, 725	57, 634	67, 713	83, 571	83, 571
Difference—payments to certificate holders-----	3, 523	2, 949	1, 641	4, 514	6, 268	7, 981	8, 383	7, 865	8, 990	8, 003	60, 117
Payments to matured certificate holders ^b -----	1, 286	751	1, 336	3, 251	3, 675	3, 595	3, 921	4, 034	4, 204	5, 059	31, 112
Payments to other certificate holders-----	2, 237	2, 198	305	1, 263	2, 593	4, 386	4, 462	3, 831	4, 786	2, 944	29, 005

^a Not shown.

^b Total of matured certificates without allowance for exercised option settlements of a total of \$898,927.

^c Includes \$2,338,275 in 1935 and \$15,369 in 1936 for called certificates.

APPENDIX D

INVESTORS SYNDICATE

Estimated period delinquency in installment payments, 1929-34

Year contracts written	Balance ^a (maturity amount)	Estimated total contract term payments made and to be made by certificate holders (75 percent of balance in force ^b)	Estimated average annual contract payments with average contract term 12½ years ^c	Number of years over 4½ months contract in existence	Estimated total matured payments for term of existence	Actual total contract payments made by certificate holders to Dec. 31, 1935	Estimated excess of matured payments (estimated) over actual payments made	Estimated approximate average past due period—over 4½ months—of unpaid matured payments
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1929.....	\$895,000	\$671,250	\$53,700	6½	\$349,050	\$115,073	\$233,977	4 years, 2 months.
1930.....	614,000	460,500	36,840	5½	202,620	80,082	122,538	3 years, 4 months.
1931.....	488,400	366,300	29,304	4½	131,868	78,255	53,613	2 years, 10 months.
1932.....	438,000	328,500	26,280	3½	91,980	64,968	27,012	1 year.
1933.....	304,200	228,150	18,252	2½	45,630	44,610	1,020	18 days.
1934.....	724,100	543,075	43,446	1½	65,169	54,765	10,404	About 3 months.

^a Total contracts written less lapses before attainment of cash surrender value.

^b From questionnaire, Table 21; redemption value of certificates which matured for the years 1927 to 1936 amounted to \$31,112,000, against which certificate holders' payments totaled \$23,096,000, or 74 percent of the redemption value—aggregate maturity amount.

^c Equals ½ of 10 years and 15 years, the maturity periods for which contracts are usually written; most contracts are of the installment type.

APPENDIX E

INVESTORS SYNDICATE

Persistency data (terminations, etc.) on certificates sold in the State of Texas for the first quarter of each year, 1929 to 1935

Particulars	Totals (as indicated)	Called for payment and death surrenders	Cancellations—flat	Total, columns 2+3	Paid-up certificates	Cash surrenders	Lapses	Total, columns 5, 6, 7	Total exits (columns 4+8)	Balance in force Dec. 31, 1935	Ratio of surrenders, etc., to issues (columns 8 to 1)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Year 1929:											
1. Aggregate maturity amounts.....	\$1,094,000	\$10,900	\$46,500	\$57,400	\$9,500	\$92,100	\$663,000	\$804,600	\$862,000	\$232,000	73.5%
2. Aggregate amount paid by contract holder.....	164,535	5,409	6,513	11,922	2,277	25,263	11,292	48,832	60,754	103,781	
3. Aggregate amount paid or credited to contract holder.....	0	5,882	6,513	12,395	8,525	19,718	0	28,243	40,638	0	
4. Ratio of (3) to (2).....	0	108.7%	100.0%	104.0%	69.4%	78.1%	0	57.8%	66.9%	0	
Year 1930:											
1. Aggregate maturity amounts.....	\$691,500	\$21,000	\$9,500	\$30,500	\$16,000	\$32,000	\$423,000	\$470,000	\$500,500	\$191,000	68.0%
2. Aggregate amount paid by contract holder.....	91,549	2,487	61	2,548	3,321	5,598	5,450	14,369	16,917	74,632	
3. Aggregate amount paid or credited to contract holder.....	0	2,644	61	2,705	1,350	3,214	0	5,564	8,269	0	
4. Ratio of (3) to (2).....	0	106.3%	100.0%	106.2%	70.8%	57.4%	0	38.7%	48.9%	0	
Year 1931:											
1. Aggregate maturity amounts.....	\$507,900	\$1,500	\$4,000	\$5,500	\$3,500	\$10,500	\$249,500	\$263,500	\$269,000	\$238,900	51.9%
2. Aggregate amount paid by contract holder.....	80,340	10	26	36	455	1,594	3,279	5,328	5,364	74,976	
3. Aggregate amount paid or credited to contract holder.....	0	10	26	36	147	817	0	964	1,000	0	
4. Ratio of (3) to (2).....	0	100.0%	100.0%	100.0%	38.3%	51.3%	0	18.1%	18.6%	0	
Year 1932:											
1. Aggregate maturity amounts.....	\$474,500	\$7,000	\$12,000	\$19,000	\$4,000	\$13,500	\$152,500	\$170,000	\$189,000	\$285,500	35.8%
2. Aggregate amount paid by contract holder.....	68,785	524	91	615	538	2,664	2,871	6,073	6,688	62,097	
3. Aggregate amount paid or credited to contract holder.....	0	565	91	656	252	1,736	0	1,988	2,644	0	
4. Ratio of (3) to (2).....	0	107.8%	100.0%	106.7%	46.8%	65.2%	0	32.7%	39.5%	0	

Year 1933:											
1. Aggregate maturity amounts.....	\$313,800	\$1,240	0	\$1,240	0	\$8,360	\$88,400	\$96,760	\$98,000	\$215,800	30.8%
2. Aggregate amount paid by contract holder.....	48,155	1,240	0	1,240	0	2,305	760	3,065	4,305	43,850	
3. Aggregate amount paid or credited to contract holder.....	0	1,340	0	1,340	0	2,175	0	2,175	3,515	0	
4. Ratio of (3) to (2).....	0	108.1%	0	108.1%	0	94.4%	0	71.0%	81.6%	0	
Year 1934:											
1. Aggregate maturity amounts.....	\$767,300	\$3,240	\$7,800	\$11,040	0	\$32,160	0	\$32,160	\$43,200	\$724,100	4.2%
2. Aggregate amount paid by contract holder.....	64,150	3,240	40	3,280	0	6,105	0	6,105	9,385	54,765	
4. Aggregate amount paid or credited to contract holder.....	0	3,382	40	3,422	0	6,288	0	6,288	9,710	0	
4. Ratio of (3) to (2).....	0	104.4%	100.0%	104.3%	0	103.0%	0	103.0%	103.5%	0	
Year 1935:											
1. Aggregate maturity amounts.....	\$1,949,800	\$2,600	\$22,100	\$24,700	0	0	0	0	\$24,700	\$1,925,100	0.0%
2. Aggregate amount paid by contract holder.....	65,499	70	189	259	0	0	0	0	259	65,240	
3. Aggregate amount paid or credited to contract holder.....	0	71	189	260	0	0	0	0	260	0	
4. Ratio of (3) to (2).....	0	101.4%	100.0%	100.4%	0	0	0	0	100.4%	0	
Summary:											
1. Aggregate maturity amounts.....	\$5,798,800	\$47,480	\$101,900	\$149,380	\$72,000	\$188,620	\$1,576,400	\$1,837,020	\$1,986,400	\$3,812,400	31.7%
2. Aggregate amount paid by contract holder.....	583,013	12,980	6,920	19,900	16,591	43,529	23,652	83,772	103,672	479,341	
3. Aggregate amount paid or credited to contract holder.....	0	13,894	6,920	20,814	11,274	33,948	0	45,222	66,036	0	
4. Ratio of (3) to (2).....	0	107.0%	100.0%	100.6%	68.0%	78.0%	0	54.0%	63.7%	0	

30.8%

4.2%

0.0%

31.7%

APPENDIX F

INVESTORS SYNDICATE

Certificate loans and repayments (cash and surrender) of certificates, 1927-36

[Amounts in thousands of dollars]

Particulars	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	Period
Loans at beginning of year.....	757	805	1,019	1,531	2,180	3,094	4,030	4,089	3,408	3,373	757
Disbursements during year ^a	446	549	960	1,380	2,199	3,053	2,488	1,482	1,615	1,968	16,140
Total.....	1,203	1,354	1,979	2,911	4,379	6,147	6,518	5,571	5,023	5,341	16,897
Payments received during year.....	72	96	98	116	171	322	468	660	696	777	3,476
Settlements by surrender of certificates ^b	326	239	350	615	1,114	1,795	1,961	1,503	954	633	9,490
Loans at end of year ^c	805	1,019	1,531	2,180	3,094	4,030	4,089	3,408	3,373	3,931	3,931
Total.....	1,203	1,354	1,979	2,911	4,379	6,147	6,518	5,571	5,023	5,341	16,897
Percent of loan settlements by—											
Cash payments.....	18%	29%	22%	16%	13%	15%	19%	31%	42%	55%	27%
Surrender of certificates.....	82%	71%	78%	84%	87%	85%	81%	69%	58%	45%	73%
Percent of loans at year ends to total certificate—Liabilities (including certificate reserve).....	4.48%	4.38%	5.14%	5.92%	7.02%	8.47%	8.06%	5.91%	4.98%	4.70%	5.98%

^a Includes relatively small amounts for loans on certificates of Investors Syndicate Title & Guaranty Co.—no data furnished.

^b Constructed amounts.

^c Includes loans on certificates of Investors Syndicate Title & Guaranty Co.; 1932, \$28; 1933, \$60; 1934, \$74; 1935, \$101; 1936, \$130; period, \$130. Interest received on loans: 1927, \$74; 1928, \$64; 1929, \$111; 1930, \$129; 1931, \$206; 1932, \$291; 1933, \$315; 1934, \$285; 1935, \$271; 1936, \$269; period \$2,015 (000 omitted in all amounts.)

APPENDIX G

INVESTORS SYNDICATE

Maturity amounts of certificates sold, terminated, and in force, 1927-36

[Amounts in thousands of dollars]

Particulars	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936
Maturity amount in force at beginning of year.....	106,438	125,445	183,346	263,145	309,846	324,283	333,219	346,152	403,465	503,856
Writings during year.....	40,267	77,786	105,186	96,836	81,332	81,359	73,900	117,797	152,470	167,337
Together:										
For year.....	146,705	203,231	288,532	359,981	391,178	405,642	407,119	463,949	555,935	671,193
Cumulative.....	146,705	224,491	329,677	426,513	507,845	589,204	663,104	780,901	933,371	1,100,708
Maturities for year—maturity amount:										
For year.....	1,286	751	1,336	3,251	3,675	3,595	3,921	4,034	4,204	5,059
Cumulative.....	1,286	2,037	3,373	6,624	10,299	13,894	17,815	21,849	26,053	31,112
Remainder after maturities:										
For year.....	145,419	202,480	287,196	356,730	387,503	402,047	403,198	459,915	551,731	666,134
Cumulative.....	145,419	222,454	326,304	419,889	497,546	575,310	645,289	759,052	907,318	1,069,596
Lapses and surrenders—maturity amounts:										
For year.....	19,974	19,134	24,051	46,884	63,220	68,828	57,046	56,450	47,875	40,685
Cumulative.....	19,974	39,108	63,159	110,043	173,263	242,091	299,137	355,587	403,462	444,147
Maturity amount in force at end of year.....	125,445	183,346	263,145	309,846	324,283	333,219	346,152	403,465	503,856	625,449
Ratio of maturities to amount in force at beginning of year and during year:										
For year.....	0.88%	0.37%	0.46%	0.90%	0.94%	0.89%	0.96%	0.87%	0.76%	0.75%
Cumulative.....	0.88%	0.91%	1.02%	1.55%	2.03%	2.36%	2.69%	2.80%	2.79%	2.83%
Ratio of lapses and surrenders to amount in force at beginning of year and writings during year:										
For year.....	13.61%	9.41%	8.34%	13.02%	16.16%	16.94%	14.01%	12.17%	8.61%	6.06%
Cumulative.....	13.61%	17.42%	19.16%	25.80%	34.12%	41.09%	45.11%	45.54%	43.23%	40.35%
Ratio of maturities to lapses and surrenders—maturity amounts:										
For year.....	6.44%	3.92%	5.56%	6.93%	5.85%	5.22%	6.87%	7.15%	8.78%	12.43%
Cumulative.....	6.44%	5.21%	5.34%	6.02%	5.94%	5.74%	5.96%	6.14%	6.46%	7.00%
Maturity amounts of exits-cumulative:										
Maturities.....	6.05%	4.88%	5.07%	5.68%	5.61%	5.43%	5.62%	5.79%	6.07%	6.55%
Lapses and surrenders.....	93.95%	95.12%	94.93%	94.32%	94.39%	94.57%	94.38%	94.21%	93.93%	93.45%

APPENDIX H
INVESTORS SYNDICATE

Main features of series of certificates sold from 1927 to 1937

Features	Series					
	50,000	200,000	A	B	D	F
Unit maturity amount.....	\$1,000.....	\$1,000.....	\$1,000.....	\$2,600.....	\$2,500.....	\$2,500.
Interest rate.....	5½ percent.....	5½ percent.....	5½ percent.....	5 percent.....	4½ percent.....	4 percent.
Period written.....	January 1927 to January 1928.	January 1928 to February 1930.	February 1930 to August 1932.	August 1932 to January 1935.	January 1935 to February 1936.	February 1936 to September 17, 1937.
Annual installment.....	\$74.....	\$74.....	\$74.....	\$114.....	\$116.....	\$120.
Maturity term.....	10 years.....	10 years.....	10 years.....	15 years.....	15 years.....	15 years.

Comparison at—

Indicated periods of	Periods									
	Cumulative installments	Cash surrender values	Cumulative installments	Cash surrender values	Cumulative installments	Cash surrender values	Cumulative installments	Cash surrender values	Cumulative installments	Cash surrender values
1 year.....	\$74	0	\$74	0	\$44	0	\$46	0	\$48	\$18
18 months.....	111	0	111	\$38½	66	\$42	70	\$26	72	(^b)
2 years.....	148	\$78	148	78	88	84	93	53	96	54
3 years.....	222	159	222	160	131	166	139	104	144	106
4 years.....	296	245	296	247	175	254	186	160	192	160
5 years.....	370	339	370	339	219	370	232	220	240	216
6 years.....	444	449	444	450	263	468	278	282	288	280
7 years.....	518	567	518	567	307	580	325	344	336	344

^a Based on maturity amount of \$1,000 with relative annual installments of \$43.846, B series; \$46.40, D series; and \$48.00, F series.

^b No stipulated 18 months cash surrender value. A greater amount than the \$18 for the first year is available only through medium of a certificate loan. Such a loan is available in 2 ways, the more favorable of which generally approximates (as is true of any mid-anniversary surrender) a total equal to the \$18 (first year amount) plus installments paid for the first 6 months of the second year.

APPENDIX I

INVESTORS SYNDICATE

Geographical distribution of certificates in force, Dec. 31, 1936

State	Maturity amount		Reserve liabilities		Estimated population, July 1, 1935	
	Total (000 omitted)	Percent of total	Total (000 omitted)	Percent of total	Number (000 omitted)	Percent, total
Alabama.....	\$19,700	3.32	\$2,625	3.33	2,834	2.24
Arkansas.....	3,190	.54	443	.56	1,999	1.58
California.....	38,087	6.43	5,345	6.78	5,639	4.46
Colorado.....	15,385	2.60	1,980	2.51	1,062	.84
Connecticut.....	25,391	4.28	3,413	4.33	1,717	1.36
District of Columbia.....	5,504	.93	736	.93	594	.47
Florida.....	9,193	1.55	1,257	1.59	1,614	1.23
Georgia.....	9,569	1.61	1,372	1.74	3,345	2.64
Idaho.....	1,063	.18	132	.17	479	.38
Illinois.....	9,193	1.55	1,307	1.66	7,817	6.18
Indiana.....	7,317	1.23	1,016	1.29	3,429	2.71
Iowa.....	17,489	2.95	2,239	2.84	2,534	2.00
Kansas.....	39,035	6.59	5,013	6.35	1,848	1.46
Kentucky.....	8,443	1.42	1,136	1.44	2,846	2.25
Louisiana.....	2,877	.49	427	.54	2,120	1.68
Maine.....	3,252	.55	399	.51	845	.67
Maryland.....	5,879	.99	786	1.00	1,669	1.32
Massachusetts.....	20,451	3.45	2,842	3.60	4,375	3.44
Michigan.....	30,144	5.09	4,057	5.14	4,661	3.68
Minnesota.....	70,522	11.90	8,963	11.36	2,627	2.08
Mississippi.....	15,322	2.59	1,979	2.51	1,961	1.55
Missouri.....	22,827	3.85	2,955	3.74	3,913	3.09
Montana.....	12,946	2.18	1,707	2.16	531	.42
Nebraska.....	1,001	.17	127	.16	1,364	1.08
Nevada.....	1,313	.22	159	.20	99	.08
New Hampshire.....	500	.08	58	.07	502	.40
New Jersey.....	10,819	1.83	1,541	1.95	4,288	3.39
New Mexico.....	2,001	.34	248	.31	402	.32
New York.....	23,703	4.00	2,932	3.72	12,889	10.20
North Carolina.....	10,257	1.73	1,511	1.91	3,417	2.70
North Dakota.....	14,759	2.49	1,870	2.37	700	.55
Ohio.....	1,313	.22	173	.22	6,707	5.30
Oklahoma.....	7,380	1.25	988	1.25	2,509	1.98
Oregon.....	5,128	.87	671	.85	1,008	.80
Pennsylvania.....	10,091	1.70	1,618	2.05	10,066	7.96
Rhode Island.....	5,941	1.00	824	1.04	681	.54
South Carolina.....	7,130	1.20	982	1.24	2,012	1.59
South Dakota.....	17,136	2.89	2,147	2.72	675	.53
Tennessee.....	19,325	3.26	2,614	3.31	2,904	2.30
Texas.....	15,823	2.67	2,177	2.76	6,077	4.80
Utah.....	9,756	1.65	1,268	1.61	515	.41
Virginia.....	13,634	2.30	1,826	2.31	2,637	2.08
Washington.....	6,504	1.10	894	1.13	1,633	1.29
West Virginia.....	11,570	1.95	1,565	1.98	1,816	1.44
Wisconsin.....	1,814	.31	234	.30	2,908	2.30
Wyoming.....	2,939	.51	362	.46	232	.18
Total.....	592,616	100.0	78,918	100.0	126,500	100.0

NOTE.—The comparisons made do not take into account the length of time the corporation has been doing business in any State.

APPENDIX J

INVESTORS SYNDICATE—EXAMPLE OF ADVERTISEMENT'



“THIS IS
A SORT OF JOURNEY
I NEVER THOUGHT TO GO”

. . . Over the Hill to the Poor House
By WILL CARLETON

The above illustration appeared with an article in *The Broadcaster*, a house organ of Investors Syndicate, May 1935 (Vol. X, No. 4, p. 9).

APPENDIX K

INVESTORS SYNDICATE

Income and expenses, classified according to main divisions, 1929-36

[Amounts in thousands of dollars]

Year	Average total assets	Gross income				Expenses of operation and interest				Profit and loss		Division of expenses of operation			
		Income (excluding initial payment receipts)		Initial payment receipts		Total gross income		Expenses of operation		Interest including appropriations to reserves		Total expenses of operation and interest		Expenses, excluding commissions	
		Amount	Per-cent ^a	Amount	Per-cent ^a	Amount	Per-cent ^a	Amount	Per-cent ^a	Amount	Per-cent ^a	Amount	Per-cent ^a	Amount	Per-cent ^a
1929.....	28,561	2,113	7.40	4,274	14.97	6,387	22.37	3,712	13.00	2,078	7.28	5,790	20.28	843	2.95
1930.....	35,508	2,511	7.07	4,276	12.04	6,787	19.11	3,662	10.32	2,956	8.32	6,618	18.64	1,236	3.48
1931.....	42,728	2,986	6.99	3,540	8.29	6,526	15.28	3,224	7.55	3,017	7.06	6,241	14.61	1,316	3.08
1932.....	48,560	3,100	6.39	2,687	5.53	5,787	11.92	3,841	7.91	1,879	3.87	5,720	11.78	2,008	4.11
1933.....	52,494	2,852	5.43	1,999	3.81	4,851	9.24	3,271	6.23	1,920	3.66	5,191	9.89	1,943	3.70
1934.....	57,126	3,431	6.01	2,060	3.61	5,491	9.62	2,952	5.17	2,519	4.41	5,471	9.58	1,363	2.39
1935.....	64,863	4,122	6.36	2,958	4.56	7,080	10.92	3,658	5.64	3,164	4.88	6,822	10.52	1,405	2.17
1936.....	78,541	5,708	7.27	3,753	4.78	9,461	12.05	4,560	5.81	4,211	5.36	8,771	11.17	1,830	2.33
Period.....	408,381	26,823	6.57	25,547	6.25	52,370	12.82	28,880	7.07	21,744	5.32	50,624	12.39	11,944	2.92
														16,936	4.15

^a Percent of average total assets.

APPENDIX L
INVESTORS SYNDICATE
Estimated earnings by the corporation (but without benefit to certificate holders) from certificate holders' funds during delinquency of installment payments, 1929-36

[Amounts (except column 3) in thousands of dollars]

Year (1)	Estimated average maturity amount certificates in force (2)	Estimated annual installments per \$1,000 of maturity amount (3)	Estimated installments due and payable		Total installments paid		Excess of estimated installments due and payable against certificates with reserve values over total installments paid		Interest and net appropriation to reserves (excluding increase in certificate reserve account) (11)	Estimated interest earned on reserves affected by delinquent installments (no credit to reserves) ^c (12)	Average total certificate liability (excluding certificate reserve account) (13)	Percent of estimated interest earned to average certificate liabilities	
			Total estimated amount (4)	Actual installments paid and applied as commissions ^a (5)	Balance ^b (6)	Amount (7)	Percent of balance (column 6) (8)	Amount (9)				Credited to reserve for certificate liability (14)	Not credited to reserve for certificate liability (15)
1929-----	\$223,000	^d 72.00	16,056	2,869	13,187	10,466	79.4	2,721	1,350	350	24,124	5.6	1.4
1930-----	286,000	^d 72.00	20,592	2,426	18,166	13,104	72.1	5,062	1,909	739	30,011	6.3	2.5
1931-----	317,000	^d 72.00	22,824	1,908	20,916	14,347	68.6	6,569	2,138	979	36,180	5.9	2.7
1932-----	^e 329,000	^e Various	21,616	1,833	19,783	12,776	64.6	7,007	1,777	974	41,140	4.3	2.4
1933-----	^f 340,000	^f Various	20,560	1,328	19,232	11,890	61.8	7,342	1,941	1,200	44,430	4.4	2.7
1934-----	^g 375,000	^g Various	21,400	1,589	19,811	14,695	74.2	5,116	1,715	596	49,005	3.5	1.2
1935-----	^h 453,000	^h Various	24,766	2,253	22,513	19,250	85.5	3,263	2,280	387	56,655	4.0	.7
1936-----	ⁱ 565,000	ⁱ Various	29,995	2,730	27,265	24,022	88.1	3,243	3,990	539	69,071	5.8	.8
									17,100	5,764			

^a Actual commissions paid, arbitrarily considered as the measure of installments due and payable applicable to certificates in force without reserve values, and therefore without an earning status; and also, and primarily, as compensating for a heavier degree of delinquency of installment payments according to the shorter the periods certificates are in force. Amounts deducted from total estimated installments due and payable to determine amount, actual and potential, applicable to certificates in force with reserve values. Data are not available as to the relative extent of delinquency according to periods for which certificates have been in force, as 2 years, 3 years, etc. However, representations are that as a rule the shorter the in-force period the greater the degree of delinquency. The allowances herein made give effect, in the arbitrary amounts shown (column 5) to such theory, though it is without proven factual basis.

^b Installments paid and due and payable applicable to or as reserve of certificates in

force affected by (having attained to) reserve values.

^c If unaffected by the conditions and calculations indicated by note *a*, above (column 5), the amounts for this column would be as follows (approximation of maturity amounts of certificates in force at the indicated annual installment payments per \$1,000 face amount): 1929, \$721,000; 1930, \$1,063,000; 1931, \$1,261,000; 1932, \$1,473,000; 1933, \$1,417,000; 1934, \$781,000; 1935, \$654,000; and 1936, \$991,000.

^d Average of \$70 and \$74.

^e \$255,000,000 at \$72; \$74,000,000 at \$44.

^f \$200,000,000 at \$73; \$140,000,000 at \$44.

^g \$175,000,000 at \$72; \$200,000,000 at \$44.

^h \$160,000,000 at \$72; \$175,000,000 at \$44; \$118,000,000 at \$47.

ⁱ \$150,000,000 at \$72; \$150,000,000 at \$44; \$125,000,000 at \$47; \$140,000,000 at \$43.

APPENDIX M-1

FIDELITY INVESTMENT ASSOCIATION; FIDEL ASSOCIATION OF NEW YORK, INC.; PAULL COMPANY; MARSTON CORPORATION

Consolidated balance sheet^a as at the close of business Dec. 31, 1936

Account	Fidelity Investment Association	Fidel Association of New York, Inc.	Paull Company	Marston Corporation	Intercompany adjustments	Consolidated total
ASSETS						
Cash on hand and on deposit.....	\$820,719.43	\$144,677.92	\$65,049.10	\$31,145.88	-----	\$1,061,592.33
Investments:						
Government and municipal bonds—Schedules A1, 2, 3.....	1,945,113.54	489,611.08	-----	-----	-----	\$2,434,724.62
Other bonds—Schedules A1, 2, 3.....	20,927,291.40	1,008,597.31	1,231,519.91	1,773,267.68	\$4,001,100.00	20,939,576.30
Preferred stock—Schedules A4, 5.....	1,247,333.52	.00	22,974.00	.00	.00	1,270,307.52
Common stock—Schedules A4, 5.....	1,347,215.54	.00	84,899.80	126,527.40	-----	1,558,642.74
Mortgage loans.....	54,896.82	.00	6,000.00	.00	-----	60,896.82
Contract loans.....	2,307,957.53	.00	.00	.00	-----	2,307,957.53
Collateral loans—Schedule A6.....	.00	.00	731,636.39	127,281.85	-----	858,918.24
Real estate—Schedule A7.....	.00	.00	.00	221,614.10	-----	221,614.10
Stock in subsidiaries.....	135,000.00	.00	.00	.00	135,000.00	.00
Total.....	27,964,808.35	1,498,208.39	2,077,030.10	2,248,691.03	4,136,100.00	29,652,637.87
Less loss taken by holding company on subsidiaries' bonds.....	-----	-----	-----	-----	411,900.00	411,900.00
Total investments.....	-----	-----	-----	-----	-----	-----
Accrued receivables:						
Interest on bonds.....	258,793.88	16,752.32	6,679.84	10,240.34	60,678.75	231,787.63
Interest on contract loans.....	324,766.34	.00	.00	.00	-----	324,766.34
Dividends on stock (cost).....	151.11	.00	.00	.00	-----	151.11
Total accrued receivables.....	583,711.33	16,752.32	6,679.84	10,240.34	-----	556,705.08
						29,240,737.87

Permanent:									
Office building.....	50,000.00								50,000.00
Office equipment.....	1.00								1.00
Total.....	50,001.00								50,001.00
Other:									
Cash value of life insurance.....	24,716.45								24,716.45
Tax notes--City of Milwaukee.....	4,266.00								4,266.00
Advances.....	1,697.04						406.35		10,403.19
	30,679.49						406.35		
Total assets.....	29,449,919.60	1,659,638.63	2,157,058.84	2,290,483.60				4,608,678.75	30,948,421.92

^a From certified audit report as of December 31, 1936.

FIDELITY INVESTMENT ASSOCIATION; FIDEL ASSOCIATION OF NEW YORK, INC.; PAULL COMPANY; MARSTON CORPORATION—Continued.

Consolidated balance sheet,^a as at the close of business Dec. 31, 1936—Continued

Account	Fidelity Investment Association	Fidel Association of New York, Inc.	Paull Company	Marston Corporation	Intercompany adjustments	Consolidated total
LIABILITIES						
Reserves:						
Required	\$25,663,708.59	\$1,446,797.98				\$27,110,506.57
Unrequired	1,538,467.86	53,569.58				1,592,037.44
Total book reserves	27,202,176.45	1,500,367.56				
Collateral trust bonds			\$2,143,000.00	\$2,270,000.00	\$4,413,000.00	\$28,702,544.01
Other liabilities:						.00
Accrued interest on bonds			29,466.25	31,212.50	60,678.75	
Unapplied collections	12,534.87	1,442.59	.00	.00	.00	13,977.46
Outstanding checks	1,260.52	.00	.00	.00	.00	1,260.52
Interest received in advance	7,701.04	.00	.00	.00	.00	7,701.04
Total other liabilities	21,496.43	1,442.59	29,466.25	31,212.50	60,678.75	22,939.02
Provisions:						
For estimated federal income taxes	51,000.00	5,300.00				56,300.00
For advertising	9,097.85	909.33				10,007.18
For other taxes	4,318.97	.00		1,104.87		5,423.84
For other costs	2,944.72	.00		.00		2,944.72
Total provisions	67,361.54	6,209.33		1,104.87		74,675.74
Total liabilities and reserves	27,291,034.42	1,508,019.48	2,172,466.25	2,302,317.37	4,473,678.75	28,800,158.77

CAPITAL							
Capital stock:							
Preferred—cumulative participating	911,000.00	100,000.00	5,000.00	5,000.00	110,000.00	911,000.00	
Common	812,300.00					812,300.00	
Total capital stock	1,723,300.00	100,000.00	5,000.00	5,000.00	110,000.00		1,723,300.00
Surplus:							
Capital surplus	56,543.67	25,000.00			25,000.00	56,543.67	
Earned surplus	379,041.51	26,619.15	b 20,407.41	b 16,833.77		368,419.48	
Total surplus	435,585.18	51,619.15	b 20,407.41	b 16,833.77	25,000.00		424,963.15
Total capital	2,158,885.18	151,619.15	b 15,407.41	b 11,833.77	135,000.00		2,148,263.15
Total liabilities, reserves, and capital	29,449,919.60	1,659,638.63	2,157,038.84	2,290,483.60	4,608,678.75		30,948,421.92

^a From certified audit report as of Dec. 31, 1936.^b Figures in red.

APPENDIX M-2
FIDEL ASSOCIATION OF NEW YORK, INC.

Balance sheet, Dec. 31, 1936

Account	Segregated funds		Unrestricted funds	Inter-fund eliminations	Total
	Series "A"	Series "B"			
ASSETS					
Cash on hand and on deposit.....	\$84,736.05	\$53,227.59	\$6,714.28	-----	\$144,677.92
Investments:					
Bonds—government and municipal.....	411,265.00	46,508.00	31,838.08	-----	\$489,611.08
Bonds—other.....	619,613.60	301,722.00	87,261.71	-----	1,008,597.31
Receivables:					1,498,208.39
Accrued interest on bonds.....	11,061.69	4,353.13	1,337.50	-----	16,752.32
Surplus participation.....			30,676.91	\$30,676.91	.00
Total assets.....	1,126,676.34	405,810.72	157,828.48	-----	16,752.32
					1,659,638.63
LIABILITIES					
Collections on new business.....		1,442.59		-----	1,442.59
Surplus participation due association—estimated.....	28,022.87	2,654.04		-----	.00
Required reserves:					
Current.....	899,236.35	311,337.32		-----	1,210,573.67
Delinquent—non-improving.....	17,302.56	457.33		-----	17,759.89
Delinquent—paid-up basis.....	30,338.38	2,642.97		-----	32,981.35
Paid-up.....	21,790.22	160.73		-----	21,950.95
Paid in full.....	57,761.71	60,974.13		-----	118,735.84
Matured or retiring.....	12,568.07	4,194.76		-----	16,762.83
Matured coupons.....	50.00			-----	50.00
Credits in lieu of insurance.....		4,949.67		-----	4,949.67

Advance collections.....	6,642.37	13,658.90			20,301.27
Accrued improvement.....	2,339.77	392.74			2,732.51
Total required reserves.....	1,048,029.43	398,768.55			1,446,797.98
Unrequired reserves:					
Credits in lieu of insurance.....		291.50			291.50
Excess of book over required reserves.....	50,624.04	2,654.04			53,278.08
Total book reserves.....	1,098,653.47	401,714.09			1,500,367.56
Provisions:					
For estimated federal income taxes.....			5,300.00		5,300.00
For advertising.....			909.33		909.33
Total liabilities and reserves.....	1,126,676.34	405,810.72	6,209.33	30,676.91	6,209.33
CAPITAL					1,508,019.48
Capital stock: Common.....			100,000.00		100,000.00
Surplus:					
Capital.....			25,000.00		25,000.00
Earned.....			26,619.15		26,619.15
Total capital.....			151,619.15		151,619.15
Total liabilities, reserves, and capital.....			157,828.48		1,659,638.63

• From certified audit report as of Dec. 31, 1936.

NOTE.—This balance sheet is subject to comments included as part of audit report.

APPENDIX M-3

PAULL COMPANY AND MARSTON CORPORATION

Paull Company—Balance sheet, as at the close of business Dec. 31, 1936

Account	Free	Trusteed fund	Total
ASSETS			
Cash on hand and on deposit	\$7,166.50	\$57,882.60	\$65,049.10
Investments:			
Bonds		1,231,519.91	1,231,519.91
Preferred stock		22,974.00	22,974.00
Common stock		84,899.80	84,899.80
Collateral loan		731,636.39	731,636.39
Mortgage receivable		6,000.00	6,000.00
Total investments		2,077,030.10	2,077,030.10
Receivables:			
Accrued interest on bonds	6,679.84		6,679.84
Advance on real estate		8,087.30	8,087.30
Other	212.50		212.50
Total receivables	6,892.34	8,087.30	14,979.64
Total assets	14,058.84	2,143,000.00	2,157,058.84
LIABILITIES			
Collateral trust bonds—3-percent series A and B:			
Authorized, \$3,000,000.			
Outstanding		2,104,000.00	2,104,000.00
To be issued		39,000.00	39,000.00
Accrued interest on bonds	29,466.25		29,466.25
Total liabilities	29,466.25	2,143,000.00	2,172,466.25
CAPITAL			
Capital outstanding	5,000.00		5,000.00
Deficit from operations to Dec. 31, 1936	^a 20,407.41		^a 20,407.41
Total	14,058.84	2,143,000.00	2,157,058.84

^a Figures in red.

NOTE.—This balance sheet is subject to comments included as part of audit report.

*Marston Corporation, Cleveland, Ohio, balance sheet, as at the close of business
Dec. 31, 1936*

Account	Free	Trusteed fund collat- eral trust bonds	Total
ASSETS			
Cash on hand and on deposit—net.....	\$9,836.91	\$21,308.97	\$31,143.88
Investments:			
Bonds.....		1,773,267.68	1,773,267.68
Common stock.....		126,527.40	126,527.40
Collateral loan.....		127,281.85	127,281.85
Real estate.....		221,614.10	221,614.10
Total investments.....		2,248,691.03	2,248,691.03
Receivables:			
Accrued interest on bonds.....	10,240.34		10,240.34
Advances.....	406.35		406.35
Total receivables.....	10,646.69		10,646.69
Total assets.....	20,483.60	2,270,000.00	2,290,483.60
LIABILITIES			
Collateral trust bonds—3-percent series A:			
Authorized, \$3,000,000.			
Outstanding.....		2,056,000.00	2,056,000.00
To be issued.....		214,000.00	214,000.00
Accrued:			
Interest on bonds.....	31,212.50		31,212.50
Taxes.....	1,104.87		1,104.87
Total liabilities.....	32,317.37	2,270,000.00	2,302,317.37
CAPITAL			
Capital stock outstanding.....	5,000.00		5,000.00
Deficit from operations to Dec. 31, 1936.....	^a 16,833.77		^a 16,833.77
Total.....	20,483.60	2,270,000.00	2,290,483.60

^a Figures in red.

NOTE.—This balance sheet is subject to comments included as part of audit report.

APPENDIX N

FIDELITY INVESTMENT ASSOCIATION

Main features of types of certificates in force Dec. 31, 1936

Features	Special income contract (offering ended 1925)	Special annuity con- tract (offering ended in 1932)	Income reserve contract series A (offering ended in 1934)	Income reserve contract series B (currently offered)	Income reserve contract series C (offering ended in 1935)	Income reserve contract series D (currently offered)
Maturity amounts: Deferred settle- ment. Cash surrender value. Payments-----	\$2,000----- (c)----- Initial \$60 (\$10 per month for 6 months) and 126 monthly of \$10 each (without in- surance). Total----- \$1,320 11 years and 8 months----	\$2,000----- \$1,550----- Initial \$60 (\$10 per month for 6 months) and 126 monthly of \$10 each (without in- surance). Total----- \$1,320 11 years and 7 months----	\$2,000----- \$1,650 without insurance. Initial \$100 (\$10 per month for 10 months) and 132 monthly of \$10 each. Total----- \$1,420 12 years and 4 months----	\$1,250----- { \$1,075 without insurance. \$1,015 with insurance----- 126 monthly of \$7.50 each.	\$860----- { \$825 without insurance-- Initial \$50 (\$5 per month for 10 months) and 132 monthly of \$5 each.	\$1,200. \$973 without insurance. 129 monthly of \$7.50 each. Total----- \$900 10 years and 9 months.
Maturity term b----- Maturity settle- ments.	\$200 per annum for 10 years beginning 140 months after due date of first monthly pay- ment, or \$150 per an- num for 10 years and beginning 36 months after due date of first monthly payment, certain specified an- nual returns.	\$200 per annum for 10 years beginning 139 months after due date of first monthly pay- ment.	\$125 per annum for 10 years beginning 130 months after due date of first monthly pay- ment, or other speci- fied optional settle- ments.	\$860 payable 145 months after due date of first monthly payment or at 10 years after ma- turity \$1,280.42.	\$120 per annum for 10 years beginning 129 months after due date of first monthly pay- ment, or other specified options deferred settle- ments.	
Reserve interest rate	5 percent compounded semiannually to ma- turity and com- pounded annually thereafter.	4½ percent compounded semiannually.	4 percent compounded quarterly.	4½ percent compounded semiannually.	4 percent compounded quarterly.	4 percent compounded annually.

Surplus participa- tion.	On matured contracts proportionate share of excess earnings of re- serve fund over amount necessary to mature contract.	On matured contracts proportionate one-half of share of excess earnings of reserve fund over amount necessary to mature contract.	On matured contracts proportionate one-half of share of excess earnings of reserve fund over amount necessary to mature contract.	On matured contracts proportionate share of one-half of excess of reserve fund over amount necessary to mature contract.	On matured contracts proportionate share of one-half of excess of reserve fund over amount necessary to mature contract.
Cash surrender-----	None-----	After initial and 1 monthly payments, and never less than monthly payments made—7 months.	After initial and 1 or more monthly pay- ments—11 months.	After initial payment(s) —10 months.	After 12 or more monthly payments.
Loan privilege-----	After initial and 24 monthly payments.	After initial and 1 monthly payments in any multiple of \$10 up to 95 percent of cash surrender.	Any amount not to ex- ceed 95 percent of cash surrender value.	Any sum not to exceed 95 percent of cash sur- render value.	After 12 or more monthly payments, amount, less interest, up to cash surrender value.
Death claim priv- ileges.	If payments not 90 days delinquent at death of certificate holder, estate may elect to (1) receive return of payments made plus matured and unpaid interest coupons, or (2) continue contract to maturity.	None-----	None-----	None-----	None.

^a No cash surrender value—loan value \$1,548, at date of payment of last installment.
Committed value as of the due date of first annual maturity settlement amount or pay-
ment, which is six months after the date of the last installment payment, \$1,620.

^b Period from due date of first monthly installment to due date of first annual maturity
settlement amount as shown under maturity settlements.

APPENDIX O

FIDELITY INVESTMENT ASSOCIATION

Geographical distribution of certificates in force, June 30, 1937

State °	Required reserves		Estimated population—July 1, 1935	
	Total (000 omitted)	Percent of total	Number (000 omitted)	Percent of total
Alabama.....	\$14	0.05	2,834	2.22
Arizona.....	5	.02	386	.30
Arkansas.....	5	.02	1,999	1.57
California.....	206	.75	5,639	4.42
Colorado.....	23	.08	1,062	.83
Connecticut.....	136	.50	1,717	1.35
District of Columbia.....	1,251	4.57	594	.47
Delaware.....	325	1.19	256	.20
Florida.....	65	.24	1,614	1.27
Georgia.....	149	.54	3,345	2.62
Idaho.....	1	.00	479	.38
Illinois.....	5,059	18.46	7,817	6.13
Indiana.....	256	.93	3,429	2.69
Iowa.....	41	.15	2,534	1.99
Kansas.....	80	.29	1,848	1.45
Kentucky.....	62	.23	2,846	2.23
Louisiana.....	16	.06	2,120	1.66
Maine.....	6	.02	845	.66
Maryland.....	724	2.64	1,669	1.31
Massachusetts.....	83	.30	4,375	3.43
Michigan.....	2,580	9.42	4,661	3.65
Minnesota.....	292	1.07	2,627	2.06
Mississippi.....	4	.01	1,961	1.54
Missouri.....	808	2.95	3,913	3.07
Montana.....	4	.01	531	.42
Nebraska.....	11	.04	1,364	1.07
Nevada.....	2	.01	99	.08
New Hampshire.....	6	.02	502	.39
New Jersey.....	360	1.31	4,288	3.36
New Mexico.....	3	.01	402	.32
New York.....	1,009	3.68	12,889	10.11
North Carolina.....	92	.34	3,417	2.68
North Dakota.....	35	.13	700	.55
Ohio.....	2,265	8.26	6,707	5.26
Oklahoma.....	112	.41	2,509	1.97
Oregon.....	3	.01	1,008	.79
Pennsylvania.....	6,354	23.19	10,066	7.89
Rhode Island.....	13	.05	681	.53
South Carolina.....	6	.02	2,012	1.58
South Dakota.....	3	.01	675	.53
Tennessee.....	107	.39	2,904	2.28
Texas.....	42	.15	6,077	4.76
Utah.....	2	.01	515	.40
Vermont.....	8	.03	377	.30
Virginia.....	385	1.40	2,637	2.07
Washington.....	14	.05	1,633	1.28
West Virginia.....	2,926	10.68	1,816	1.42
Wisconsin.....	1,449	5.29	2,908	2.28
Wyoming.....	4	.01	232	.18
Total.....	27,406	100.00	127,519	100.00

° Foreign countries (\$88,000).

APPENDIX P

FIDELITY INVESTMENT ASSOCIATION

Payments by certificate holders and, separately, payments to holders of matured and surrendered certificates, 1927-36

[Amounts in thousands of dollars]

Particulars	1927	1928	1929	1930	1931	1932
<i>A. Without excluding effect of transfers</i>						
Reserves, beginning of year.....	10,451	12,559	15,290	19,008	23,905	27,753
Payments by certificate holders.....	3,277	3,911	5,556	7,113	8,466	8,543
Together.....	13,728	16,470	20,846	26,321	32,371	36,296
Reserves at end of year.....	12,559	15,290	19,008	23,905	27,753	23,671
Balance as payments to certificate holders, etc..	1,169	1,180	1,838	2,216	4,618	12,625
Maturities.....	^a 661	242	635	959	1,352	1,652
Surrenders.....	808	768	839	792	2,341	9,133
Together.....	^a 1,469	1,010	1,474	1,751	3,693	10,785
Difference, or other utilization ^b	(300)	170	364	465	925	1,840
<i>B. Excluding effect of transfers (payments on contracts applied on new contracts in transfers from one series to another)</i>						
Reserves, beginning of year.....	10,451	12,559	15,290	19,008	23,905	27,753
Payments by certificate holders.....	2,974	3,698	5,273	6,865	8,065	2,267
Together.....	13,425	16,257	20,563	25,873	31,970	30,020
Reserves, end of year.....	12,559	15,290	19,008	23,905	27,753	23,671
Balance as payments to certificate holders, etc..	866	967	1,555	1,968	4,217	6,349
Maturities.....	^a 661	242	635	959	1,352	1,652
Surrenders.....	506	556	556	545	1,938	2,857
Together.....	^a 1,166	797	1,191	1,504	3,290	4,509
Difference, or other utilization ^b	(300)	170	364	464	927	1,840

Particulars	1933	1934	1935	1936	Period
<i>A. Without excluding effect of transfers</i>					
Reserves, beginning of year.....	23,671	22,172	22,604	24,974	10,451
Payments by certificate holders.....	7,209	5,719	6,450	6,279	62,523
Together.....	30,880	27,891	29,054	31,253	72,974
Reserves at end of year.....	22,172	22,604	24,974	28,702	28,702
Balance as payments to certificate holders, etc..	8,708	5,287	4,080	2,551	44,272
Maturities.....	956	1,440	1,304	1,216	^a 10,417
Surrenders.....	7,080	4,060	2,589	1,827	30,237
Together.....	8,036	5,500	3,893	3,043	^a 40,654
Difference, or other utilization ^b	672	(213)	187	(492)	^b 3,618
<i>B. Excluding effect of transfers (payments on contracts applied on new contracts in transfers from one series to another)</i>					
Reserves beginning of year.....	23,671	22,172	22,604	24,974	10,451
Payments by certificate holders.....	3,775	4,358	5,741	6,214	49,230
Together.....	27,446	26,530	28,345	31,188	59,681
Reserves, end of year.....	22,172	22,604	24,974	28,702	28,702
Balance as payments to certificate holders, etc..	5,274	3,926	3,371	2,486	30,979
Maturities.....	956	1,440	1,304	1,216	^a 10,417
Surrenders.....	3,646	2,700	1,880	1,762	16,944
Together.....	4,602	4,140	3,184	2,978	^a 27,361
Difference, or other utilization ^b	672	(214)	187	(492)	^b 3,618

^a Includes \$590,000 for which corresponding payment by certificate holder was paid in previous years. All years are to some extent so affected.

^b See Appendix U, p. 173—total \$3,618,000 plus excess or unrequired reserves of \$1,591,000 equals net depreciation of \$5,209,000.

APPENDIX Q

FIDELITY INVESTMENT ASSOCIATION

Maturity amount of certificates sold, terminated, and in force, 1927-36

[All amounts are maturity amounts and are in thousands of dollars]

Particulars	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936
<i>A. Without giving effect to (including) transfers</i>										
In force at beginning of year-----	87,527	98,851	116,728	150,170	191,765	231,660	236,064	228,245	229,124	232,575
Writings (sales) during year-----	21,602	27,394	46,520	57,778	66,718	52,862	39,820	31,871	29,355	27,165
Together:										
For year-----	109,129	126,245	163,248	207,948	258,483	284,522	275,884	260,116	258,479	259,740
Cumulative-----	109,129	136,523	183,043	240,821	307,539	360,401	400,221	432,092	461,447	488,612
In force at end of year-----	98,850	116,728	150,170	191,765	231,660	236,064	228,245	229,124	232,575	247,062
Terminations or exits:										
For year-----	10,238	9,517	13,078	16,183	26,823	48,458	47,639	30,992	25,904	12,678
Cumulative-----	10,278	19,795	32,873	49,056	75,879	124,337	171,976	202,968	228,872	241,550
Matured certificates:										
For year-----	192	306	802	1,102	1,661	1,914	1,154	1,561	1,563	1,993
Cumulative:										
Amount-----	192	498	1,300	2,402	4,063	5,977	7,131	8,692	10,255	12,248
Percent ^a -----	0.17	0.36	0.71	1.00	1.32	1.66	1.78	2.01	2.22	2.51
Lapsed and surrendered certificates: ^b										
For year-----	10,086	9,211	12,276	15,081	25,162	46,544	46,485	29,431	24,341	10,685
Cumulative:										
Amount-----	10,086	19,297	31,573	46,654	71,816	118,360	164,845	194,276	218,617	229,302
Percent ^a -----	9.24	14.13	17.25	19.37	23.35	32.84	41.19	44.97	47.38	46.93
Percent of terminations or exits:										
For year-----										
Maturities-----	1.87	3.22	6.13	6.81	6.19	3.95	2.42	5.04	6.03	15.72
Lapses and surrenders-----	98.13	96.78	93.87	93.19	93.81	96.05	97.58	94.96	93.97	84.28
Cumulative:										
Maturities-----	1.87	2.52	3.95	4.90	5.35	4.81	4.15	4.28	4.48	5.07
Lapses and surrenders-----	98.13	97.48	96.05	95.10	94.65	95.19	95.85	95.72	95.52	94.93

<i>B. Giving effect to (eliminating) transfers</i>									
In force at beginning of year.....	87,527	98,851	116,728	150,170	191,765	231,660	236,064	228,245	229,124
Writings (sales) during year.....	16,004	22,440	41,382	52,280	60,626	33,958	17,903	23,604	18,685
									232,575
									25,760
Together:									
For year.....	103,531	121,291	158,110	202,450	252,391	265,618	253,967	251,849	247,809
Cumulative.....	103,531	125,971	167,353	219,633	280,259	314,217	332,120	355,724	374,409
In force at end of year.....	98,851	116,728	150,170	191,765	231,660	236,064	228,245	229,124	232,575
Terminations or exits:									
For year.....	4,680	4,563	7,940	10,685	20,731	29,554	25,722	22,725	15,234
Cumulative.....	4,680	9,243	17,183	27,868	48,599	78,153	103,875	126,600	141,834
Matured certificates:									
For year.....	192	306	802	1,102	1,661	1,914	1,154	1,561	1,563
Cumulative:									
Amount.....	192	498	1,300	2,402	4,063	5,977	7,131	8,692	10,255
Percent ^a	0.19	0.40	0.78	1.09	1.45	1.90	2.15	2.44	2.74
Lapsed and surrendered certificates: ^b									
For year.....	4,488	4,257	7,138	9,583	19,070	27,640	24,568	21,164	13,671
Cumulative:									
Amount.....	4,488	8,745	15,883	25,466	44,536	72,176	96,744	117,908	131,579
Percent ^a	4.33	6.94	9.49	11.60	15.89	22.97	29.13	33.15	35.15
Percent of terminations or exits:									
For year:									
Maturities.....	4.10	6.71	10.10	10.31	8.01	6.48	4.49	6.87	10.26
Lapses and surrenders.....	95.90	93.39	89.90	89.69	91.99	93.52	95.51	93.13	89.74
Cumulative:									
Maturities.....	4.10	5.39	7.57	8.62	8.36	7.65	6.86	6.87	7.23
Lapses and surrenders.....	95.90	94.61	92.43	91.38	91.64	92.35	93.14	93.13	92.77
									17.68
									82.32
									8.00
									92.00

^a Of cumulative in force at beginning of year and writings during year.

^b Lapses are relatively small, being limited to 4 series of contracts sold prior to 1925. Subsequently written contracts, with delinquency of installment payments and which have not acquired a cash surrender value, are subject to continuance or revival through redating and renewal and installment payments, generally any time within a period of 10 years from the beginning of the month for first monthly installment payments. The stated terminations are therefore relieved of potentially and practically demised or abandoned contracts, but which have technical attributes of potential existence. Likewise the "in force" amounts are burdened with contracts so affected.

APPENDIX R

FIDELITY INVESTMENT ASSOCIATION

Classified operating expenses, 1927-36

[Amounts in thousands of dollars]

Executive salaries-----	294	Maintenance—building and equip-	
Office salaries-----	855	ment-----	32
Directors' fees-----	28	Light and heat-----	15
Branch office rents (Branch \$80,000)-----	95	Taxes, licenses, etc-----	53
Stationery and printing-----	197	Sales promotion expense-----	84
Postage-----	140	Rent of tabulating machines (since	
Telephone and telegraph-----	39	1930)-----	31
Legal, accounting, and actuarial-----	346	Lithographing contracts-----	75
Dues and subscriptions-----	24	Trustees' fees (since 1931)-----	18
Traveling expense-----	98	Branch office expense-----	203
Collection expense-----	18	Miscellaneous-----	95
Insurance-----	67		
Advertising (including reserves)-----	95	Total-----	2,902

APPENDIX S

FIDELITY INVESTMENT ASSOCIATION

Analysis of surplus accounts, 1927-36

[Amounts in thousands of dollars]

EARNED SURPLUS

Balance Jan. 1, 1927	73
Credits:	
Profit from operations	^a 1,347
Unused investment loss reserve	85
Refund of stamp taxes (including reserve)	145
Unrequired contract reserves	170
Miscellaneous	3
	<u>1,750</u>
Subtotal	1,823
Debits:	
Federal taxes (including reserve)	^b 146
Cash dividends paid	287
Stock dividends	858
Reserve for contingencies	154
Funding adjustments	10
	<u>1,455</u>
Balance Dec. 31, 1936	<u>368</u>

CAPITAL SURPLUS

Balance Jan. 1, 1927	7
Premium on capital stock sold	50
Balance Dec. 31, 1936	<u>57</u>
^a Amount per income statements	\$1,200,000
Federal tax items—net debit—eliminated from income and/or expenses and included in surplus account	\$81,000
Net of 5 other items in 1936 eliminated from surplus account (net interest credit \$95,000 and investment—debit—losses \$29,000) and included in income and/or expenses	66,000
	<u>147,000</u>
Total	<u>1,347,000</u>

^b \$81,000 transferred from statement of operating expenses.

APPENDIX T FIDELITY INVESTMENT ASSOCIATION

Income and expenses, classified according to main divisions, 1927-36

[Amounts in thousands of dollars]

Year	Average total assets	Gross income				Expenses of operation and interest				Profit and loss		Division of expenses of operation			
		Income (excluding installment deductions)		Installment deductions		Total gross income		Expenses of operation		Interest (including reserve fund income increment)		Total expenses of operation and interest		Expenses excluding commissions	
		Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent
1927	13,512	907	6.7	567	4.2	1,474	10.9	529	3.9	878	6.5	1,407	10.4	154	1.1
1928	15,917	978	6.2	717	4.5	1,695	10.7	684	4.3	932	5.9	1,616	10.2	179	1.1
1929	18,618	1,289	6.9	1,135	6.1	2,424	13.0	1,071	5.8	1,184	6.3	2,255	12.1	221	1.2
1930	22,599	1,272	5.6	1,450	6.4	2,722	12.0	1,386	6.1	1,229	5.4	2,615	11.5	261	1.1
1931	27,092	951	3.5	1,726	6.4	2,677	9.9	1,618	6.0	932	3.4	2,550	9.4	296	1.1
1932	27,210	^a (143)	(.5)	1,697	6.2	1,554	5.7	1,694	6.2	^a (112)	(.4)	1,582	5.8	376	1.4
1933	24,785	1,227	4.9	1,340	5.4	2,567	10.3	1,392	5.6	1,123	4.5	2,515	10.1	335	1.4
1934	24,226	1,458	6.0	1,002	4.2	2,460	10.2	1,107	4.6	1,219	5.0	2,326	9.6	365	1.5
1935	25,472	2,053	8.1	1,470	5.7	3,523	13.8	1,599	6.3	1,763	6.9	3,362	13.2	502	2.0
1936	28,863	^b 3,157	10.9	1,323	4.6	4,480	15.5	1,633	5.7	2,368	8.1	4,001	13.8	717	2.5
Period	228,294	13,149	5.8	12,427	5.4	25,576	11.2	12,713	5.6	11,516	5.0	24,229	10.6	3,406	1.5
														9,307	4.1

^a Gives effect to loss on securities, \$1,190,000.

^b As data for Fidelity Association of New York not available amount estimated at \$100,000. Total includes profit on sale of bonds and stocks in the sum of \$1,323,000 and interest adjustment of \$355,000.

\$149,000; 1933, \$316,000; 1934, \$394,000; 1935, \$506,000; 1936, \$905,000: total, \$2,893,000. Reserve funds data furnished were on a receipts and disbursements basis with certificate installment payments and income as receipts, and payments against certificates and expenses as disbursements. Hence income and expense items were resolved according to character indicated by accounting terminology of the statements. Therefore, to an important degree the figures may involve inaccuracies. The effect of the treatment described is likewise applicable, in part, to "interest (including reserve fund increment)."

NOTE.—Amount from corporation's account, as distinguished from reserve fund account, to wit: 1927, \$91,000; 1928, \$102,000; 1929, \$170,000; 1930, \$127,000; 1931, \$133,000; 1932,

APPENDIX U

FIDELITY INVESTMENT ASSOCIATION

Summary payments by and to certificate holders, both for maturities and surrenders, and like payments by holders of certificates in force Dec. 31, 1936, with reserve fund thereagainst

[Amounts in thousands of dollars]

Particulars	Maturity amount	Percent of—		Payments by certifi- cate holders	Payments to and retained for certifi- cate holders
		Termina- tions	Grand total		
	(1)	(2)	(3)	(4)	(5)
<i>Terminations, 1927-1936</i>					
Maturities.....	11, 248	7. 4	2. 8	8, 117	10, 417
Surrenders.....	140, 859	92. 6	35. 3	20, 954	16, 944
Total terminations.....	152, 107	100. 0	38. 1	29, 071	27, 361
In force Dec. 31, 1936.....	247, 062	-----	61. 9	30, 611	27, 111
Grand total.....	399, 169	-----	100. 0	59, 682	54, 472

Summary:

Total payments by certificate holders.....	\$59, 682, 000
Total payments to certificate holders.....	\$27, 361, 000
Total amount retained for certificate holders.....	27, 111, 000
	54, 472, 000

Net depreciation and loss..... 5, 210, 000

To wit:

Losses by lapsed and surrendered certificate holders.....	4, 010, 000
Shrinkage on "in force" certificates.....	3, 500, 000
	7, 510, 000
Together.....	7, 510, 000
Less: Gain by matured certificate holders.....	2, 300, 000
	5, 210, 000

• Estimated in part as indicated by Section X, B, supra, pp. 108 et seq.

APPENDIX V

INVESTORS SYNDICATE

Copy of Agreement between Investors Syndicate and Midland National Bank & Trust Company under which property is deposited to secure certificate liability of Investors Syndicate to the holders of its certificates who are residents of Massachusetts.

AGREEMENT made this 22d day of June 1928, by and between the Investors Syndicate, a corporation organized and existing under and by virtue of the laws of the State of Minnesota, with its principal place of business in said State, hereinafter referred to as "the Syndicate," party of the first part, and Midland National Bank & Trust Company, a corporation organized and existing under and by virtue of the laws of the United States of America, with its principal place of business in Minneapolis in said State, authorized to do a trust business in the State of Minnesota, hereinafter referred to as the "Trust Company," party of the second part.

WITNESSETH, That for and in consideration of a dollar and other valuable considerations by each of the parties to the other paid, the receipt whereof is hereby acknowledged, the parties agree as follows:

I

The Syndicate agrees to deposit with the Trust Company, from time to time, duly assigned first mortgages on improved real estate, together with the notes secured thereby duly endorsed, or securities such as the Laws of Massachusetts authorize as legal investments for Savings Banks of Massachusetts, or cash (the foregoing being hereinafter for brevity referred to as "Collateral Securities"), to adequately secure all bonds, certificates, or obligations of any kind on the partial payment or installment plan, issued and sold by the Syndicate in the Commonwealth of Massachusetts, the total amount of said Collateral Securities on deposit to equal at all times not less than \$110 for every \$100 of the liability of the Syndicate on all such bonds, certificates, or obligations sold in the Commonwealth of Massachusetts (the said liability being determined and defined as in such bonds, certificates, or obligations), less the amount of any loans made on said bonds, certificates, or obligations by the Syndicate to the holders thereof.

Except as hereinafter provided, collections on said collateral securities shall be made by the Syndicate, and not by the Trust Company, and the Trust Company shall not be accountable nor responsible for any sums so collected.

II

Accompanying any mortgages deposited, there shall be delivered to the Trust Company:

1. Assignments of the mortgages duly executed, with the names of the assignee left blank.
2. The notes secured thereby, duly endorsed.
3. The Attorney's Opinion as to title or title insurance certificate, or Torrens Title Certificate.
4. The Fire Insurance Policy covering the said mortgaged premises, with a mortgage clause in favor of the Syndicate.
5. An appraisal of the real property mortgaged, showing the amount of the loan to be not in excess of 60% of the fair market value of the premises mortgaged.

The Trust Company shall issue duplicate receipts listing the various documents received as hereinbefore in this Section provided, one to be sent to the Commissioner of Banks of the Commonwealth of Massachusetts, and the other to the Syndicate.

The aforesaid Collateral Securities, when so deposited with the Trust Company, shall be held and kept by said Trust Company so long as any liability exists upon any of said bonds, certificates or obligations sold in Massachusetts; *provided, however*, That the Syndicate shall have the right to withdraw Collateral Securities at any time, so long as securities of the class mentioned in Paragraph I hereof shall be substituted therefor in like amount, or in amount sufficient to maintain the deposit hereinbefore mentioned; and if at any time the Trust Company has on hand a margin of securities over and above the amount necessary, then the surplus may be, at the option of the Syndicate, withdrawn. Interest coupons, if any, shall be surrendered by the Trust Company to the Syndicate not more than fifteen days prior to their respective maturities in order that the Syndicate may collect the same.

III

Each month the Syndicate shall file with the Trust Company the following:

1. A statement sworn to by an officer of the Syndicate, showing the total liability upon all such bonds, certificates, or obligations sold in Massachusetts, and outstanding as of the last day of the preceding month, said liability being determined and defined as in such bonds, certificates, and obligations.
2. A statement sworn to by an officer of the Syndicate showing all collateral securities on deposit with the Trust Company, collections made thereon during the preceding month, and the unpaid balance thereon as of the last day of the preceding month.

Such sworn statements shall also be forwarded each month by the Syndicate to the Commissioner of Banks of the Commonwealth of Massachusetts, to the end that it may readily check and see that said deposit of Collateral Securities is being maintained.

The Trust Company shall maintain a record in ledger form of the Collateral Securities deposited with it by the Syndicate, to which shall be credited additional securities deposited from time to time, and against which shall be charged—

- (a) Collateral Securities withdrawn by the Syndicate from time to time as herein provided.
- (b) Collections made by the Syndicate upon such Collateral Securities, reported at the end of each month, as provided in this Section.

IV

The Commissioner of Banks of the Commonwealth of Massachusetts, or any person or agent designated by him, shall have the right at all times to examine and to check over the said Collateral Securities so deposited with the Trust Company, and the record thereof maintained by the Trust Company.

V

The Trust Company may at any time resign by notice in writing mailed to the Syndicate and to the Commissioner of Banks of the Commonwealth of Massachusetts, thirty days before such resignation shall be effective, and shall resign if requested so to do by either the Syndicate or Commissioner of Banks of Massachusetts, but in such event shall deliver all the collateral securities remaining in its hands to a successor depository named by the Syndicate, and in writing approved by the Commissioner of Banks of Massachusetts, or by a Court of competent jurisdiction, upon the written receipt of such depository, which receipt shall fully discharge and release the Trust Company from all liability under this agreement. The succeeding depository shall thereupon have the same rights, duties, and obligations as though it were herein named as depository.

If the Syndicate in compliance with any laws that may hereafter be enacted adequately secures all bonds, certificates, and obligations such as are hereinbefore referred to, and sold by the Syndicate in the Commonwealth of Massachusetts, then this agreement shall be at an end, and all Collateral Securities held by the Trust Company shall be surrendered and delivered to the Syndicate; this clause shall not be effective unless and until thirty days' written notice shall have first been given by the Syndicate to the Commissioner of Banks of Massachusetts.

VI

In case the Syndicate shall fail to meet or pay its liabilities on any such bond, certificate, or obligation sold by it in the Commonwealth of Massachusetts (the said liability being determined and defined as in such bonds, certificates, and obligations), as and when the same matures, or otherwise becomes due, the Trust Company shall use so much of the Collateral Securities held by it hereunder as may be necessary to pay and meet such liabilities on such bonds, certificates, or obligations. To this end the Trust Company shall have the right to sell any Collateral Securities which it may hold hereunder, first giving to the Syndicate fourteen days' notice of the time and place and manner of any proposed sale of Collateral Securities; shall make such sale at public auction; shall have the right to collect on any note or mortgage held as collateral security, and to foreclose the same, either in its own name or the name of the Syndicate, and apply the proceeds (less proper expenses, if any), so far as may be necessary, to meet and pay such liability. In case the liability of the Syndicate on any such bond, certificate, or obligation hereinbefore referred to shall be disputed by the Syndicate, and written notice is

given by the Syndicate to the Trust Company that it does dispute such liability, then no action shall be taken by the Trust Company until 10 days after the liability shall have been finally adjudged by a competent Court, or settled by the parties.

VII

After the payment of its liabilities on all such bonds, certificates, or obligations sold by the Syndicate in Massachusetts (the said liability being determined and defined as in such bonds, certificates, and obligations), the Trust Company shall pay or turn over to the Syndicate all collateral securities then held hereunder. The Trust Company shall, however, not make such final payment or delivery of securities until it has first given to the Bank Commissioner of Massachusetts, a written notice of its intention so to do, and until after the expiration of thirty days from the mailing of such notice, and if during said thirty days, the Trust Company shall have received notice from the Bank Commissioner of Massachusetts, or from any holder of such bond, certificate, or obligation sold by the Syndicate, in Massachusetts, that there is objection to the delivery to the Syndicate of the Collateral Securities, it shall continue to hold the same for an additional 30 days, and to await any action that may be brought during said period.

VIII

The Trust Company shall incur no liability for or in respect of the validity or sufficiency of this agreement, nor for or in respect of the title or value or priority of lien of the Collateral Securities at any time deposited with it. The Trust Company shall not be responsible for the recording of any mortgage, assignment thereof, or any other instrument. The Trust Company shall be under no obligation to make collections on any of the Collateral Securities or to preserve the liability thereon of makers, endorsers, sureties, or guarantors.

The Trust Company shall be under no duty to pay or keep itself informed as to taxes or assessments on real property covered by mortgages delivered to it, nor to effect insurance against fire or other damage to any portion of said real property, nor to renew any policies of fire or other insurance thereon; nor shall the Trust Company be liable or responsible for the collection or adjustment of any insurance in case of loss. All matters recited herein and in the Certificates and Coupons secured thereby shall be conclusively deemed to be statements of the Syndicate and not of the Trust Company.

The Trust Company shall be protected and held harmless in acting upon any attorney's opinion, any appraiser's certificate or other instrument or paper, provided for in this agreement, and believed by the Trust Company to be genuine and to be signed or executed by the proper party.

As to any fact upon which the Trust Company shall be required or permitted to take or refrain from taking action, the Trust Com-

pany may accept as conclusive the sworn certificate of any officer of the Syndicate, except as hereinbefore expressly provided.

IN WITNESS WHEREOF the parties hereto have executed this agreement by and through their proper officers thereunto duly authorized by their respective Board of Directors, and have caused their corporate seals to be affixed as of this 22nd day of June 1928.

INVESTORS SYNDICATE,

By E. E. CRABB, *Vice President*.

By E. M. RICHARDSON, *Secretary*.

MIDLAND NATIONAL BANK &

TRUST CO. OF MINNEAPOLIS,

By _____, *Vice President*.*

By _____, *Asst. Trust Officer*.*

* Names not contained in the copy submitted to the Commission.

APPENDIX W

STATE REGULATION OF INVESTORS SYNDICATE

This appendix consists of a description and brief discussion of state regulatory laws applicable to Investors Syndicate. It is included as a sample study and supplements the general discussion of governmental regulation contained in Chapter V hereof.

There are several types of state statutes which have been applied to the Corporation in the sale of its certificates. The following table shows the general type of regulation effective in the various states:

Number of states in which—

Certificates are sold.....	44
Security registration laws are applicable.....	21
Security dealers laws are applicable.....	7
Investment company laws are applicable.....	8
Security fraud laws are applicable.....	3
Special laws ^a are applicable.....	12
Deposit of collateral security against certificate liability is required ^b	30
State approval of advertising is required.....	21
Right of state officers to examine books is provided.....	12
Injunction is provided for violation of statutory standards.....	26
The Corporation is licensed as a broker or dealer.....	15
Laws or regulations limiting selling commissions are applicable.....	26

^a Special laws connote statutes such as insurance or banking statutes or special provisions thereof.

^b Six of these 30 states require a fixed sum to be deposited without reference to the dollar amount of the Corporation's liability on certificates outstanding in those states, which liability in all cases greatly exceeds the amount of such deposit.

It may be noted that in a number of states more than one type of statute is applicable to the Corporation.

1. DOMICILIARY REGULATION ¹

The Corporation was incorporated under the laws of Minnesota in 1894, has always maintained its principal place of business in that state and carried on its business therein as a domestic corporation.

There are three statutes of Minnesota under which the Corporation operates: the general corporation law; ² the securities law, ³ and the investment companies law. ⁴

a. General Corporation Statutes

The general corporation statutes provide for the organization of corporations, their powers and duties, the powers and duties of officers and directors, and the rights and liabilities of stockholders.

¹ The regulation to which the Corporation was subject, under the Minnesota statutes, was discussed in the testimony of E. E. Crabb, vice president of the Corporation at the public examination thereof. See Public Examination, Investors Syndicate, at 21533-39.

² Mason's Minnesota Statutes, Ch. 58, Secs. 7429 to 8031.

³ Id., Secs. 3996 to 4000.

⁴ Id., Secs. 7771 to 7774, as amended by laws, 1937, Ch. 271.

There appears to be no provision in these statutes of particular pertinence to a consideration of the question of the regulation of the business of the Corporation.

It is significant to observe, in this connection, that the Corporation is not organized under the Minnesota statute authorizing the formation of insurance companies and the carrying on of the insurance business.⁵ Neither its original charter nor any amendments thereto contain any provision authorizing the Corporation to engage in the insurance business.⁶ An amendment to the Corporation's charter dated January 27, 1926, authorizes it to act as principal or broker in the sale of insurance, in the following terms:⁷

To buy, sell and deal in any and all kinds of insurance and surety bonds either for itself or as agents or brokers for other companies. To exercise and use any and all other necessary and incidental powers authorized by the State of Minnesota to insure a full and free use of the foregoing enumerated powers.

It will be observed that there is no power to contract as insurer, i. e., to engage in the insurance business.

It is also significant that the Corporation is not organized under the banking statutes of Minnesota⁸—i. e., is not incorporated as a bank, nor is it regulated as a bank in any state. Neither the charter of the Corporation nor any amendments thereto grant any right to accept deposits or otherwise engage in the banking business.⁹

The Corporation is subject to a special act of the legislature relating to investment companies which provides that the superintendent of banks shall have certain supervisory jurisdiction over such companies.¹⁰

Thus, the Corporation is incorporated as an ordinary business corporation, not as a bank or insurance company, and carries on business as such in the state of its domicile.

b. Securities Law

The Securities Law provides for the registration of securities sold within the state. The Department of Commerce, composed of the Commissioner of Banks, the Commissioner of Insurance, and the Commissioner of Securities, presently administers this act. This agency is given the power, in connection with applications for registration, to compel the production of information additional to that contained in the application for registration, to order appraisals, audits or other examinations into the affairs of the company, and to place conditions, limitations, or restrictions on the registration. Respecting the power of the Department of Commerce to deny an application for registration, the statute provides:¹¹

The Commission shall have the power to deny an application for registration if the securities are fraudulent or if it appears to the Commission that the sale thereof would work a fraud on purchasers thereof, or if the applicant has violated any of the provisions of this Act, or any registration or lawful order of the Commission, or for good cause appearing to the Commission.

⁵ Mason's Minnesota Statutes Ch. 19, Secs. 3287 to 3769.

⁶ Reply to the Commission's questionnaire for Investors Syndicate, Item 2 (a).

⁷ Ibid.

⁸ Mason's Minnesota Statutes, Ch. 58, Sec. 7659 et seq.

⁹ Reply to the Commission's questionnaire for Investors Syndicate, Item 2 (a).

¹⁰ See section c. *supra*.

¹¹ Mason's Minnesota Statutes, Secs. 3996 (5).

In 1920 the State Securities Commission, predecessor of the Department of Commerce as the administrator of the Act, found that the sale of the installment certificates of the Corporation worked a fraud upon investors and accordingly suspended the Corporation's license to sell the certificates in Minnesota. It appears that the principal basis of the Commission's order was a consideration of the losses suffered by certificates holders by reason of lapses and surrenders in the early years of the certificates. Upon application by the Corporation to the Supreme Court of Minnesota for a review of this order, the Court reversed the order on the ground that no fraud had been shown within the meaning of the statute. After reviewing the facts, the opinion concluded:¹²

The Commission does not view the savings contracts as of such nature that the syndicate will be unable to perform them. If it performs them, the purchaser will get what is promised. *The investment contract is often an unprofitable one for the purchaser.* It is so when he fails to make his payments. We do not inquire as to the limits of the right of the statute to supervise investment contracts of the general nature of the one before us. It is enough to say that the investment certificate does not work a fraud upon purchasers within the meaning of the statute. Order reversed. [Italics supplied.]

c. Investment Companies Law

The so-called investment companies law, a section of the corporation law, was passed in 1909.¹³ By its terms various types of enterprises, "doing business as a so-called investment, loan, benefit, cooperative, home, securities, trust or guarantee company" are subjected to the jurisdiction of the state superintendent of banking. The statute does not define the extent of the power which it reposes in the banking superintendent to examine, supervise, regulate or control the companies subject to the act. It merely provides that such powers as he may lawfully exercise shall, as far as applicable, be exercised by him or his deputy. The section provides as follows:¹⁴

The persons, co-partnerships, associations and corporations mentioned or enumerated in the foregoing section are hereby put under the supervision of the state commissioner of banks. The powers, authority, privileges and duties conferred upon him for the purpose of examining, supervising, controlling and regulating the action of and for the liquidation of each and every class of financial institution to the full extent *to which he may at any time lawfully exercise them* shall each and all, so far as applicable, be exercised by him personally or by deputy in the examination, supervision, control, regulation and liquidation of the persons, co-partnerships, associations and corporations hereinbefore mentioned. [Italics supplied]

Any such enterprise must submit its plan of operation to the banking commissioners who—

If he finds that the same contains no feature essential proposition which is likely to be injurious or defraud the public,¹⁵

may issue a permit to do business in the state. It is a criminal offense under the statute so to engage in business without such a permit.

¹² *In re Investors Syndicate*, 147 Minn. 217, 179 N. W. 1001, 1002. Decided November 19, 1920.

¹³ Mason's Minnesota Statutes, Ch. 58, Secs. 7771 to 7774. (Acts of 1909, Ch. 333.)

¹⁴ *Id.*, Sec. 7772.

¹⁵ *Id.*, Sec. 7774.

The Corporation has reported to the Commission,¹⁶ and one of its officials has testified,¹⁷ that the banking commissioner of Minnesota makes a thorough annual examination of the Corporation, at the latter's offices; that the examination consumes the time of a large staff of examiners for a long period. The examination as of December 31, 1935 was cited as an example and it was stated that the examination began on December 2, 1935 and was completed on April 12, 1936; that the examining force averaged 20 examiners for a considerable period, and that "at the height of the examination forty-five examiners were employed."¹⁸ However, there are no data available as to the extent to which appraisals are made or as to the exact scope of the examinations.

2. NONDOMICILIARY REGULATION

a. Securities Registration Laws

(1) GENERAL

In 20 of the remaining states the Corporation is required to register its certificates or contracts as securities under securities ("Blue Sky") laws which provide for the registration with specified state agencies of securities sold in those states. The states are: Alabama,¹⁹ California,²⁰ Colorado,²¹ Florida,²² Georgia,²³ Illinois,²⁴ Indiana,²⁵ Kansas,²⁶ Kentucky,²⁷ Michigan,²⁸ Missouri,²⁹ North Carolina,³⁰ Oklahoma,³¹ Oregon,³² South Carolina,³³ South Dakota,³⁴ Utah,³⁵ Virginia,³⁶ Washington,³⁷ and West Virginia.³⁸ In all these

¹⁶ Derived from supplementary information supplied the Commission for Investors Syndicate.

¹⁷ Public Examination, Investors Syndicate, at 21533-9.

¹⁸ Derived from supplementary information supplied the Commission for Investors Syndicate.

¹⁹ Alabama, Code, Secs. 9877 to 9900, as amended.

²⁰ California, Laws 1917, c. 532, as amended by laws, 1931, c. 423; Laws 1933, c. 898; Laws 1933, c. 166, 766.

²¹ Colorado, Laws 1923, c. 168; Laws 1931, c. 95 as amended.

²² Florida, Laws 1931, c. 14899, as amended.

²³ Georgia, Code of 1933, Title 97, Secs. 97-101.

²⁴ Illinois, Laws 1919, p. 351, as amended.

²⁵ Indiana, Laws 1925, c. 31; Burns' Annotated Statutes, 1926, Secs. 5006-5027, as amended.

²⁶ Kansas, R. S. Supplement, Secs. 17-1223 to 17-1248 incl., as amended.

²⁷ Kentucky, Laws 1932, c. 17; Statutes, Sec. 165a-1 to Sec. 165a-58, as amended.

²⁸ Michigan, P. A. 1923, Act. 220; C. L. 1929, Secs. 9769 to 9801, incl., as amended.

²⁹ Missouri, Laws 1929, p. 387; R. S. 1929, Secs. 7724 to 7754, incl.

³⁰ North Carolina, P. L. 1927, c. 149, as amended; Michie's Code 1931, Secs. 3924 (a) to 3924 (x), incl.

³¹ Oklahoma, Laws 1931, c. 24, Art. 11, O. S. 1931, Secs. 4897 to 4915, as amended.

³² Oregon, Laws 1929, O. 461; O. C. 1930, Secs. 25-1301 to 25-1327, incl., as amended.

³³ South Carolina, Laws 1915, c. 160, as amended; Code 1932, Secs. 8116 to 8134, incl.

³⁴ South Dakota, Laws 1927, c. 206, as amended.

³⁵ Utah, Revised Statutes 1933, Title 82, c. 1.

³⁶ Virginia, Laws 1928, c. 529; Code 1930, Secs. 3848 (47) to 3848 (65), incl., as amended.

³⁷ Washington, Laws 1923, c. 69.

³⁸ West Virginia, Code 1931, c. 32, Art. 1 as reenacted and amended by Laws 1935, c. 104.

states, except Michigan and West Virginia,³⁹ there are no other statutes of a regulatory character under which the Corporation operates.

These securities registration laws are administered by various agencies either ex officio or especially created for that purpose.⁴⁰

The statutes provide without exception that the security be registered by means of an application, on a form which is usually supplied. The application usually requires the applicant to supply pertinent information including copies of contracts and other documents and various financial statements which might be relevant to a decision on the application. All 20 states require the registration of specific securities, and of these, 16 states require the securities to be registered in specified amounts.⁴¹ All 20 states require the agents or salesmen to be licensed by the administrative agency. Two of these states require such agents or salesmen to be bonded to the state.⁴²

Eighteen states require the Corporation to file periodic financial statements or reports.⁴³ These reports were variously required to be filed quarterly, semiannually, or annually.⁴⁴ Only three states required an annual financial report certified by certified public accountants.⁴⁵ Only one state—Illinois—required the inclusion of any special provision in the certificates or contracts.

Of the 20 states, 14 had provisions in their securities registration statutes requiring the deposit with some institution or agency of securities or funds to secure the performance of the obligations contained in certificates or obligations outstanding in those states.⁴⁶

³⁹ These two states have, in addition to their Blue Sky laws, special regulatory statutes which are applicable to the Corporation. See discussion *infra*, *Special Laws*, p. 188.

⁴⁰ The agencies charged with administration of the securities registration laws in the various states, are as follows: Alabama, Attorney General; California, Commissioner of Corporations; Colorado, Division of Securities; Florida, Commission composed ex officio of State Treasurer, Comptroller, and Attorney General; Georgia, Secretary of State; Illinois, Secretary of State; Indiana, Securities Commissioner (Secretary of State, ex officio); Kansas, State Corporation Commission; Kentucky, Dept. of Business Regulation, Division of Securities; Michigan, Corporation and Securities Commission; Missouri, Supervisor of Corporation Registration; North Carolina, Secretary of State; Oklahoma, Securities Commission (Bank Commissioner, State Auditor, and Secretary of State, ex officio); Oregon, Corporation Commission; South Carolina, Insurance Commissioner; South Dakota, Securities Commission (Superintendent of Banks, Insurance Commissioner, and Attorney General, ex officio); Utah, State Securities Commission (Bank Commissioner, Attorney General, and Secretary of State, ex officio); Virginia, State Corporation Commission; Washington, Director of Licenses; West Virginia, State Auditor.

⁴¹ The states which do not require registration of securities in limited and specified amounts are: Illinois, Kentucky, South Carolina, and Washington.

⁴² Alabama and South Dakota.

⁴³ The only states in this group which do not require such periodic reports are Oklahoma and South Carolina.

⁴⁴ Alabama, California, North Carolina, and Utah required quarterly reports; Florida, Georgia, Illinois, Indiana, Kansas, Michigan, and Washington required semiannual reports; Colorado, Kentucky, Missouri, Oregon, South Dakota, Virginia, and West Virginia required annual reports.

⁴⁵ Alabama, Colorado, and California.

⁴⁶ These states, with the amounts on deposit at December 31, 1937, are as follows:

Alabama-----	\$2, 574, 359. 48	North Carolina-----	\$1, 660, 281. 26
California-----	5, 266, 212. 34	South Dakota-----	2, 089, 240. 97
Florida-----	147, 068. 86	Utah-----	1, 296, 022. 42
Georgia-----	1, 592, 955. 18	Virginia-----	100, 363. 28
Illinois-----	1, 175, 394. 19	Washington-----	983, 690. 57
Kansas-----	4, 649, 612. 98	West Virginia-----	1, 674, 893. 48
Missouri-----	2, 990, 627. 94		

All these states which required these deposits required periodic reports on the status of the deposit accounts.

The information as to the amounts on deposit is taken from supplementary information supplied the Commission for Investors Syndicate.

These are the main provisions of the Blue-Sky laws of the 20 states discussed. None of these provisions puts upon the Corporation any restrictions or burdens not imposed alike on any other corporation which sells securities in those states. In only one state was the insertion of protective provisions in the Corporation's certificate or contracts required.⁴⁷

E. E. Crabb, vice president of the Corporation, testified concerning the question of the extent of regulation under state securities registration laws as a whole, as follows: ⁴⁸

Q. Of course, in any state, provisions like Blue Sky Acts would apply to corporations, no matter what their business, wouldn't they?

A. That may be true, but I believe in the case of an investment company they usually exercise them more than they would over an ordinary business corporation.

Q. But that isn't a matter of statute; that is simply a matter of practice of your State Securities Commission; isn't it?

A. Yes; I should think that is right.

In a case before the United States District Court for the Western District of Missouri, Central Division,⁴⁹ in 1926, the Corporation sought to reverse the denial of an application for registration of the Corporation, by the Supervisor of Corporations for Missouri, based on a finding by the supervisor that the certificates would work a fraud, deception, or injustice on the purchasers. The District Court reversed the finding of the supervisor on the ground that in its opinion the provisions of the contracts were not per se overreaching; that the matter was one of business judgment.

The survey of the security registration laws in these 20 states thus leads to the conclusions that in 18 states ⁵⁰ where the Corporation is subject to Blue-Sky laws alone the regulation is of the same type applicable to any other Corporation offering its securities in such states.

b. Dealers' Laws

In seven states the Corporation is required to register under so-called "dealers' laws," that is, laws requiring any person offering securities for sale within such state, whether issued by such persons or otherwise, to register as a dealer. The states having these requirements are Colorado, Connecticut, Maine, Massachusetts, Nebraska,

⁴⁷ Illinois (see p. 183).

⁴⁸ Public Examination, Investors Syndicate, at 21544.

⁴⁹ *Investors Syndicate v. Becker*, Secretary of State for the State of Missouri, et al.; United States District Court for the Western District of Missouri, No. 60, In Equity. The finding of the Court was the basis of a temporary injunction, the case being dismissed by stipulation before reaching final decree. (Letter to Commission from A. L. Arnold, Clerk of the Court referred to, dated September 30, 1938.)

⁵⁰ It will be recalled that 2 of the 20 states having this type of statute—Michigan and West Virginia—also have a special statute applicable to the Corporation. The regulation of these 2 states will be discussed infra, Sec. 2, e (3), p. 189, and Sec. 2, e (9), p. 191.

Pennsylvania, and Rhode Island.⁵¹ The States of Nebraska and Pennsylvania also have special laws under which the Corporation is required to qualify.⁵² In the other states mentioned, except Colorado, which has a securities registration law, the dealers law is the only statute applicable to the Corporation in the sale of its certificates.

To register as a dealer the Corporation must file certain information as to the type of certificate it sells, its method of doing business, certain financial information, and the like. The administration of the laws in the seven states is under a body either especially created or composed of various state officials *ex officio*.⁵³ All these states require annual registration renewal by the Corporation as well as annual registration or renewal for salesmen. All but one state⁵⁴ require some deposit or bond by the Corporation as dealer, ranging from a flat \$10,000 bond to a deposit based on the amount of certificate liability outstanding in the state.⁵⁵ All the states but Maine require annual reports of condition from the Corporation as dealer. All the seven states have some control over the advertising of the Corporation.

Under the Nebraska Statute the Corporation in 1924 filed an application with the appropriate state authorities for the renewal of its application to sell its certificates in the State of Nebraska. Various citizens of the state filed a remonstrance with the authorities against the issuance of the permit sought, alleging among other things that the Corporation's plan of doing business was unfair, unjust, inequitable and oppressive to the class of investors who ordinarily purchase the certificates of the Corporation. A hearing was held by the administrative department at which testimony of the remonstrants and in behalf of the Corporation was taken. Subsequently the department denied the application for a permit. The Corporation thereupon filed a bill of complaint in the state District Court to restrain the state officials from interfering with the conduct of its business by denying the permit. Upon denial of the relief sought, the Corporation appealed to the Supreme Court of the State of Nebraska,⁵⁶ urging that the Statute was unconstitutional, and violative of Section 1 of the Fourteenth Amendment of the Constitution of the United States; that the action of the department was arbitrary and without authority. The Corporation urged that the statute was unconstitutional because

⁵¹ The citations of the respective state statutes are as follows: Colorado, Laws, 1923, c. 168, as amended; Laws, 1931, c. 9 S., as amended. Connecticut, G. S., 1930, c. 212, as amended. Maine, R. S., 1930, ch. 57, Secs. 162-176, incl., as amended. Massachusetts, 9 L., ch. 110 A, as amended and revised by L. 1932, c. 290. Nebraska, Laws, 1921, c. 308; C. S. 1929, Secs. 81-5401-81-5431, incl., as amended. Pennsylvania, Laws, 1927, p. 273, as amended; Laws, 1921, No. 176, P. L. 374, as amended. Rhode Island, G. L., c. 273, as amended.

⁵² See discussion *infra*, pp. 189 and 190.

⁵³ The administrative agencies in the 7 states are: Colorado, Division of Securities; Connecticut, Bank Commissioner; Maine, Bank Commissioner; Massachusetts, Department of Public Utilities, Securities Division; Nebraska, Director of Insurance and Superintendent of Banks; Pennsylvania Securities Commission; Rhode Island, Banking Commissioner.

⁵⁴ Rhode Island.

⁵⁵ The requirements of bonds or deposits are as follows: Colorado, \$25,000 deposit; Connecticut, deposit equal to 110% of certificate liability; Maine, \$10,000 bond; Massachusetts, deposit equal to 110% of certificate liability; Nebraska, deposit equal to \$110 of certificate; Pennsylvania, \$100,000 deposit.

⁵⁶ *Investors Syndicate v. Bryan*, 205 N. W. 294.

it vested in an administrative board absolute, unregulated and undefined discretion to grant or withhold certificates of approval under general statutory language and fixed no standards to which an applicant might knowingly conform. The Court found that the action of the board was not arbitrary or without authority, that the statutes were constitutional, and accordingly affirmed the lower court.⁵⁷ The Supreme Court of the United States, to which the Corporation appealed, in a per curiam decision affirmed the decision of the State Court.⁵⁸

It would appear that the dealers laws of these seven states put no requirement on the Corporation not applicable to every securities dealer.

c. Investment Company Laws⁵⁹

In eight states the Corporation is required to register under statutes applicable to investment companies before selling its certificates in those states. The States are: Arizona, Arkansas, Idaho, Louisiana, Mississippi, Montana, North Dakota, and Tennessee.⁶⁰ These statutes are directed specifically at investment companies and require the registration of either such companies themselves or their specific securities. Administered by various agencies,⁶¹ five states require the registration of the specific certificates,⁶² two states require merely the registration of the Corporation⁶³ and one state requires the registration of both the Corporation and the specific certificates.⁶⁴ Of the states requiring the registration of the certificates alone, four require such registration for specific amounts of certificates.⁶⁵ All but one state, Louisiana, require the filing with the state officials of periodic financial statements of the Corporation. Of these states, two require annual reports⁶⁶ and the remaining five states require semi-annual reports.⁶⁷

Six of the eight states provide some jurisdiction over advertising of the Corporation, either requiring such advertising to be filed or, infrequently, to be approved.⁶⁸ All the eight states require the agents or salesmen of the Corporation to be licensed. Two states require a

⁵⁷ Ibid.

⁵⁸ *Investors Syndicate v. Bryan*, 274 U. S. 717.

⁵⁹ These so-called investment company laws are merely securities registration statutes which define as investment companies practically every type of corporation which sells its securities in those states. While this type of statute is here treated separately it may be regarded for all practical purposes as a securities registration statute.

⁶⁰ The citations of the respective statutes are as follows: Arizona, R. S. 1928, c. 38, Secs. 1887-1903, incl. Arkansas, Law, 1927, Act No. 354, as amended; Laws, 1931, Act 109. Idaho, Code, 1932, Secs. 25-1601 to 25-1621, incl. Louisiana, Laws, 1920, Act No. 177. Mississippi, Code, Ch. 100, Article 2, as amended by Laws 1932, c. 88. Montana, Laws, 1913, c. 85, as amended; R. C. Secs. 4026-4055. North Dakota, Laws, 1923, c. 182 (secs. 5235a 1 to 5235a 26, incl., as amended. Tennessee, Code 1932, secs. 6056-6070, incl.).

⁶¹ Arizona, Corporation Commission; Arkansas, State Bank Commissioner; Idaho, Commissioner of Finance; Louisiana, Securities Commission; Mississippi, Secretary of State; Montana, Investment Commissioner; North Dakota, State Securities Commission; Tennessee, Commissioner of Banking and Insurance.

⁶² Arizona, Arkansas, Idaho, Louisiana, and Mississippi.

⁶³ Montana and Tennessee.

⁶⁴ North Dakota.

⁶⁵ Arizona, Idaho, Louisiana, and Mississippi.

⁶⁶ Arizona and Montana.

⁶⁷ Arkansas, Idaho, Mississippi, North Dakota, and Tennessee.

⁶⁸ Arizona, Arkansas, Idaho, Mississippi, Montana, and North Dakota.

bond of the Corporation as issuer.⁶⁹ Three states require a deposit to secure certificate liability, in all three cases, equal to 110% of such liability,⁷⁰ and one state, Tennessee, requires in addition an issuer's bond in the penalty of \$5,000. One state, Louisiana, requires the Corporation to register also as a dealer.

In certain instances where state agencies have attempted an application of standards set up in the various statutes, and have found that the standards were not met, the decisions of the state agencies overruled by the courts. For example, in 1925 the Commissioner of Finance of Idaho required the Corporation to deposit certain property to secure the performance of its obligations under certificates outstanding in that state, as a condition to the issuance of a permit to sell its certificates. The Corporation thereupon filed a bill of complaint in the United States District Court for the Southern District of Idaho, praying that it be relieved of the condition. The court held that the Commissioner of Finance was not authorized under the statute to require such a deposit.⁷¹ The permit was accordingly issued without a deposit.

Again, in the State of Montana, operating under an investment company statute and presumably applying the statutory standards, the Commissioner of Finance issued an order that a loading charge of 5% to 8% was inequitable, that a maximum withdrawal penalty of 3½% was adequate in cases of forfeiture and that withdrawals by certificate holders should be permitted any time after one year following the issuance of the certificate. The Commissioner stated that he deemed his order necessary to remedy conditions which were the subject of many complaints from certificate holders alleging misrepresentation in the sale of the certificates. The Corporation filed a bill of complaint in the United States District Court for the District of Montana to restrain the enforcement of the order. The District Court reversed the order and issued an injunction against the enforcement of the order by the Commissioner.⁷²

On appeal to the Supreme Court of the United States,⁷³ the decision was reversed on technical grounds and remanded for further proceedings in conformity with the opinion.⁷⁴

d. Fraud Laws

In three states,⁷⁵ the regulation of the Corporation in the sale of its certificates consists of its subjection to "fraud laws." These laws

⁶⁹ Arkansas and Mississippi.

⁷⁰ Louisiana, North Dakota, and Tennessee.

⁷¹ *Investors Syndicate v. Commissioner*, etc., United States District Court for Southern District of Idaho (1925) No. 1200 (unreported).

⁷² *Investors Syndicate v. Porter*, 52 Fed. (2nd) 195. A vigorous dissenting opinion was filed in this case by District Judge Bourquin condemning the methods of the Corporation's salesmen.

⁷³ *Porter, Auditor, v. Investors Syndicate*, 286 U. S. 461.

⁷⁴ *Ibid.* The grounds for reversal were that the Corporation had not exhausted its remedies under the statute before seeking equitable relief.

⁷⁵ This does not include the State of New York in which the New York subsidiary exclusively carries on the business of the Corporation in its own name, but does include Maryland and New Jersey which have other types of statutory regulation applicable to the Corporation. The latter regulation is discussed in the subsection immediately following under the caption, "Special Laws." The New York regulation is discussed later in this section under the caption, "New York Regulations."

may or may not require a registration of the Corporation or its certificates prior to selling the certificates, but provide that if fraudulent sales are made the appropriate state agency may, upon complaint, investigate the Corporation and upon a proof of fraud, cause the Corporation to be enjoined from further sales within such states. Delaware, Maryland and New Jersey have such statutes,⁷⁶ administered in each case by the state attorney general.

The Delaware law provides no prerequisite registration for sale. In other words, any person may sell its own or other securities without any preliminary qualification or registration.

Only in cases of fraud may the Attorney General file a bill in chancery to enjoin the sale. The Maryland and New Jersey statutes are similar, although recently Maryland has required a preliminary registration, largely a pro forma filing.⁷⁷

e. Special Laws

There are nine states in which the Corporation is subject to some "special law," that is, a statute which has particular application to the Corporation and companies of the same type. These states are: Iowa,⁷⁸ Maryland,⁷⁹ Michigan,⁸⁰ Nebraska,⁸¹ New Jersey,⁸² Ohio,⁸³ Pennsylvania,⁸⁴ Texas,⁸⁵ and West Virginia.⁸⁶

The following table shows the type of applicable law in each of the nine states together with the agency which administers it:

State	Administrative agency	Type of law
Iowa.....	Auditor of state.....	Installment Securities Law.
Maryland.....	Insurance commissioner.....	Installment Contracts Law.
Michigan.....	State treasurer.....	Finance Company Law.
Nebraska.....	Superintendent of banks.....	Installment Investment Company Law.
New Jersey.....	Bank commissioner.....	Investment Companies.
Ohio.....	Superintendent of insurance.....	Bond Investment Company Law.
Pennsylvania.....	Securities commission.....	Installment Companies Law.
Texas.....	Banking commissioner.....	Loan and Brokerage Companies Law.
	State treasurer.....	Bond Investment Company Law.
West Virginia.....	Insurance commissioner.....	Annuity Contracts Law.

⁷⁶ Delaware, Rev. Code 1935, c. 117, Sec. 3. Maryland, Laws, 1920, c. 552; Annotated Code, 1924, Article 32-A, Secs. 11-14, as amended. New Jersey, Laws, 1927, c. 79, as amended.

⁷⁷ Still more recently the legislature of New Jersey has enacted a registration law applicable to the Corporation, which places investment companies of this type under the Commissioner of Banking and Insurance, gives this official the right to require information and documentary exhibits, and to conduct examinations of such companies, and requires a deposit with the Commissioner of property in the amount of \$50,000. If the applicant corporation has \$100,000 or more on deposit in the state of its domicile, such applicant need not make the deposit in New Jersey, and sets up certain substantive requirements. This act was effective as of October 1, 1938. N. J. Laws, 1938, ch. 322.

⁷⁸ Iowa, Code 1935, Ch. 292, Secs. 8517-8524, as amended.

⁷⁹ Maryland, Laws 1931, ch. 530, sec. 184-199, incl., Annotated Code 1924, 1935 supplement, Art. 48-A, Secs. 184-200.

⁸⁰ Michigan, Laws 1925, Act 307, as amended; Annotated Statutes, Ch. 239, Secs. 23, 611-23, 627.

⁸¹ Nebraska, Comp. Stat. 1929, 81-5101 to 81-5111, as amended.

⁸² New Jersey, R. I. 1937, Sec. 17; 16-1 to 17:16-79.

⁸³ Ohio, Code (1936), Secs. 697-709.

⁸⁴ Pennsylvania, Purdon's Pennsylvania Statutes (1936), Secs. 781-798.

⁸⁵ Texas, Vernon's Texas Statutes, 1936, Title 19A, Art. 600a; Title 21, Sec. 696-700; Art. 6165a.

⁸⁶ West Virginia, Code, 1937, ch. 32, Secs. 3273 (1) to 3273 (31).

The provisions of the statutes of the nine states, as applicable to the Corporation may be summarized as follows:

(1) IOWA

The installment securities law of Iowa applicable to the Corporation supplements the state securities act. In addition to compliance with the statute, the Corporation must file an application to sell its certificates with the Auditor of State. The application must contain a description of the Corporation and its method of doing business and be accompanied by certain financial schedules. If it appears that the Corporation's method of doing business is not fraudulent, the Auditor of State, with the approval of the Executive Council, may issue a permit to do business. A right of examination of the Corporation's affairs is given the Auditor of State who may revoke the permit if he discovers fraud, insolvency, or other violations of statutory standards.

(2) MARYLAND

The State of Maryland has a special statute, commonly called the Investment Contracts Law, which was passed in 1931 to supply some statutory regulation to the installment investment contract business. Under the provisions of this statute the Corporation is required to apply to the Insurance Commissioner of the state for authority to do business. Various exhibits, including the charter, by-laws, and financial data are required to accompany the application, together with a power of attorney of the corporation appointing the Insurance Commissioner to accept service of process for the Corporation. The Commissioner is authorized to examine the affairs of the Corporation to determine if its business is in the public interest and may at any time require an examination to the same end. He must make a complete examination at least once during his term of office.⁸⁷ He may revoke the Corporation's license for insolvency or for violation of the statutory standards. A deposit of at least \$25,000 and in no case less than the aggregate contract liability of the Corporation within the state must be maintained by the latter in a financial institution approved by the Commissioner.

(3) MICHIGAN

In Michigan the Corporation is subject to the Finance Company Law. Under the statute the Corporation applies for registration with the state treasurer, filing all pertinent information on prescribed forms. If the treasurer is satisfied that the Corporation is not insolvent and that its business is not fraudulent or inequitable he issues a permit to do business. Semiannual reports must be issued by the Corporation. The right of examination is given to the treasurer in the enforcement of the statute.

⁸⁷ This right, given to enforcement agencies or their deputies in some of the states, to go to the home office or other offices of a foreign corporation doing business in that state and make an examination of the Corporation's books, usually is accomplished by having the applicant Corporation stipulate to permit such an examination as a condition precedent to qualification to do business as a foreign corporation in the state. This method is adopted in Maryland, for example.

(4) NEBRASKA

In Nebraska the Corporation must file an application to do business with the Superintendent of Banking under the Installment Investment Company Law. Upon due application including the filing of description of the Corporation's plan of operation and all pertinent documents and financial schedules, the superintendent makes an examination thereof to determine if the plan of business is fair, just and equitable, and if he so finds, he issues a certificate of approval. Annual financial statements are required of the Corporation and the superintendent has the right to revoke the certificate of approval if he finds that the Corporation has violated the statute. The certificate must be renewed annually.

(5) NEW JERSEY⁸⁸

The Corporation is included under the definition of investment companies under the New Jersey banking act and, therefore, subject to the jurisdiction of the Commissioner of Banking and Insurance. In order to secure a certificate of authority to do business the Corporation must file an application setting forth pertinent information, supported by documentary exhibits and financial statements. If the Commissioner finds that the standards prescribed by the statute have been met, he issues certificates which must be renewed annually. Annual reports of financial condition are required of the Corporation. The Commissioner has a right of examination into the Corporation's affairs and the right to revoke its license if statutory standards are violated. A standing deposit of \$30,000 is required of the Corporation.

(6) OHIO

In Ohio the Corporation is registered under a statute applicable to "bond investment companies." This statute provides for the issuance of a certificate of authority to do business upon a finding by the Commissioner of Insurance that the Corporation meets statutory requirements. A standing deposit of at least \$100,000 is required. Annual financial statements must be filed. Periodic examinations by the Commissioner of Insurance are provided and the commissioner is authorized to revoke the license upon the discovery of a violation of the statute.

(7) PENNSYLVANIA

The installment company law under which the Corporation operates in Pennsylvania is a section of the state securities act. The statute requires the Corporation to apply to the Securities Commission, submitting pertinent financial and other information, for a license to do business. The Commission is thereupon required to examine the data, or call for additional data if necessary, and if it finds that the statutory standards have been met, it issues the license. A standing deposit of \$100,000 is required of the Corporation.

⁸⁸ Op. cit. supra, note 79.

(8) TEXAS

In Texas the Corporation operates under two special statutes—a loan and brokerage law and a bond investment trust law. The loan and brokerage law, a part of the banking statutes prescribes a minimum paid-in capital of \$10,000. It requires the commissioner to make annual examinations of subject companies, and authorizes him to make as many additional examinations as he deems proper. Contract forms are required to be filed with the commissioner and the right to do business and the right to continue in business are conditioned upon the observance of statutory standards. A deposit is required of the Corporation in an amount equivalent to the total certificate liability in the state to be placed in a custodial institution approved by the commissioner.

The Corporation is also subject to the “bond investment company law” administered by the state treasurer. A special deposit equal to 10% of amounts received by certificate holders up to \$100,000 is required, which amount thereafter continues as a standing deposit.

The Corporation reports that this deposit is credited under the deposit account required under the loan and brokerage law.⁸⁹

The Corporation is exempted under the Texas securities law, but its salesmen are licensed thereunder.

(9) WEST VIRGINIA

In West Virginia the Corporation is licensed under the Annuity Contracts Law. Under this statute the Corporation must file an application with the Insurance Commissioner. Upon deposit with the State Treasurer of \$100,000, in cash or approved securities, a license to do business is secured, which must be renewed annually.

The State Auditor, who is the Insurance Commissioner, has the right of examination under the state securities statute to which the Corporation is also subject and may revoke the Corporation’s license upon a violation of statutory standards.

f. Deposit Requirements

One of the requirements of various state authorities which has been urged as an important factor in state regulation is that providing for a deposit, either with state officials or in institutions approved by state officials, of cash and securities as security for the performance of the Corporation’s obligations. There are 30 states which require such deposits, classified as follows:

	<i>Number of states</i>
Fixed sum-----	6
Amount equal to contract liability-----	1
Amount equal to 110% of contract liability-----	18
Amount equal to contract liability plus \$100,000-----	1
Amount equal to contract liability subsequent to July 3, 1931-----	1
Amount equal to one-tenth of contract liability plus 10%-----	1
Amount equal to undivided interest of subscribers-----	1
Amount equal to withdrawal value of contracts under certain permits subsequent to May 20, 1931-----	1
	30

⁸⁹ Derived from supplementary information supplied the Commission for Investors Syndicate.

The states, with information as to the character and amount of deposit required, and the surrender value of outstanding certificates as at December 31, 1935, were as follows: ⁹⁰

[Amounts in thousands of dollars]

	Basis	Nature	Deposits required (amount)	Surrender value of outstanding certificates, Dec. 31, 1935
Alabama.....	Liability plus 10 percent.....	Mortgages and bonds.....	\$1, 852	\$1, 694
California.....	do.....	Bonds and mortgages.....	2, 795	2, 531
Connecticut.....	do.....	do.....	2, 088	1, 898
Florida.....	Fixed amount.....	Mortgages.....	100	663
Georgia.....	Liability plus 10 percent.....	Bonds and mortgages.....	707	645
Illinois.....	Liability subsequent to July 7, 1931.....	Bonds.....	391	571
Iowa ^a	Liability.....	Bonds and mortgages.....	2, 269	1, 921
Kansas.....	Liability plus 10 percent.....	do.....	3, 553	3, 270
Louisiana.....	do.....	Mortgages.....	177	163
Maryland.....	do.....	Bonds and mortgages.....	478	437
Massachusetts.....	Liability plus 10 percent.....	Bonds and mortgages.....	1, 367	1, 429
Michigan.....	do.....	Mortgages.....	2, 501	2, 307
Minnesota.....	Fixed amount.....	do.....	100	6, 008
Missouri.....	Liability plus 10 percent.....	Bonds and mortgages.....	2, 038	1, 847
Nebraska.....	do.....	Mortgages.....	108	98
Nevada.....	One-tenth of liability plus 10 percent.....	do.....	15	134
New Jersey.....	Fixed amount.....	Bonds.....	30	722
New York ^b	Equal to undivided interest of subscribers.....	Mortgages.....	2, 297	2, 279
North Carolina.....	Liability plus 10 percent.....	Bonds and mortgages.....	766	698
North Dakota.....	do.....	do.....	1, 442	1, 311
Oregon.....	do.....	do.....	455	416
Ohio.....	Fixed amount.....	do.....	100	-----
Pennsylvania.....	do.....	Bonds.....	100	502
South Dakota.....	Liability plus 10 percent.....	Bonds and mortgages.....	1, 592	1, 460
Tennessee.....	do.....	do.....	1, 610	1, 470
Texas.....	Withdrawal value under permit subsequent to May 20, 1931.....	do.....	324	1, 035
Utah.....	Liability plus 10 percent.....	do.....	885	804
Virginia.....	Fixed amount.....	Bonds.....	40	1, 022
Washington.....	Liability plus 10 percent subsequent to Apr. 21, 1930.....	Bonds and mortgages.....	407	440
West Virginia.....	Liability plus \$100,000.....	do.....	993	893
Wyoming.....	Fixed amount.....	Mortgages.....	50	334

^a Includes figures for Investors Syndicate Title & Guaranty Co.

^b Data are for Investors Syndicate Title & Guaranty Co.

⁹⁰ Reply to the Commission's questionnaire for Investors Syndicate, Item 18, Table 16.

The same table, revised to December 31, 1937, is as follows:⁹¹

State	Amount of deposit *	Cash value of certificates outstanding	State	Amount of deposit *	Cash value of certificates outstanding
Alabama.....	\$2, 574, 359. 48	\$2, 206, 996. 96	New York.....	\$4, 357, 675. 58	\$4, 039, 017. 08
California.....	5, 266, 212. 34	4, 659, 471. 50	North Carolina.....	1, 660, 281. 26	1, 427, 228. 51
Colorado.....	25, 066. 47	1, 689, 142. 45	North Dakota.....	1, 785, 129. 00	1, 579, 933. 90
Connecticut.....	3, 655, 947. 62	3, 043, 956. 81	Ohio.....	100, 265. 87	206, 489. 28
Florida.....	147, 068. 86	1, 042, 579. 06	Oregon.....	691, 454. 96	581, 782. 38
Georgia.....	1, 592, 955. 18	1, 378, 212. 25	Pennsylvania.....	100, 265. 87	1, 918, 522. 08
Illinois.....	1, 175, 394. 19	1, 355, 142. 83	South Dakota.....	2, 089, 240. 97	1, 766, 230. 48
Iowa.....	2, 585, 940. 26	2, 035, 911. 58	Tennessee.....	2, 743, 769. 41	2, 484, 382. 19
Kansas.....	4, 649, 612. 98	4, 373, 613. 31	Texas.....	1, 227, 868. 70	2, 053, 735. 56
Louisiana.....	551, 234. 44	463, 249. 06	Utah.....	1, 296, 022. 42	1, 097, 808. 80
Maryland.....	917, 982. 76	747, 359. 31	Virginia.....	100, 363. 28	1, 717, 084. 50
Massachusetts.....	2, 965, 302. 19	2, 635, 390. 83	Washington.....	983, 690. 57	865, 738. 88
Minnesota.....	125, 260. 27	7, 856, 240. 32	West Virginia.....	1, 674, 893. 48	1, 480, 497. 15
Missouri.....	2, 990, 627. 94	2, 595, 458. 01	Wyoming.....	60, 755. 07	258, 030. 42
Nebraska.....	119, 220. 17	162, 844. 19			
Nevada.....	25, 107. 02	102, 108. 36			
New Jersey.....	30, 079. 76	1, 469, 928. 48			
			Total.....	48, 269, 048. 37	59, 291, 086. 52

* Securities at book values.

The total certificate liability (i. e., cash value of certificates) on December 31, 1937, in those states requiring such deposits was \$59,291,086.52 against which there were deposits which at their book values amounted to \$48,269,048.37. At the same date the total certificate liability of the Corporation and its New York subsidiary was \$106,350,990.81.⁹²

Of these deposits under the requirements of 30 states those of 16 states are in the custody of Midland National Bank & Trust Company of Minneapolis,⁹³ presumably approved by the various state authorities. The deposits for one state—California—are kept in a local institution, the Union Bank & Trust Company of Los Angeles.⁹⁴ The remaining 13 states require that the deposit be made directly with appropriate state officials.⁹⁵

It is reported by the Midland National Bank & Trust Company that the deposits are segregated by states and that the securities are so earmarked and are kept separately by it. It does not appear that independent appraisals are made of real estate or mortgages on real estate by or on behalf of either the bank or the state officials.⁹⁶

⁹¹ Derived from supplementary information supplied the Commission for Investors Syndicate.

⁹² Derived from supplementary information supplied the Commission for Investors Syndicate. This figure includes liability on certificates outstanding in Canada.

⁹³ Derived from supplementary information supplied the Commission for Investors Syndicate. These states are Alabama, Connecticut, Florida, Georgia, Kansas, Louisiana, Maryland, Massachusetts, Missouri, North Carolina, North Dakota, Oregon, South Dakota, Tennessee, Utah, and Washington. Two of these states—Kansas and North Carolina—have local institutions as codepositaries.

⁹⁴ Ibid.

⁹⁵ The 13 states, with the respective officials with whom the deposits are made, are Colorado, State Treasurer; Illinois, Secretary of State; Iowa, State Auditor; Minnesota, State Treasurer; Nebraska, Superintendent of Banks; Nevada, State Treasurer; New Jersey, Commissioner of Banking & Insurance; Ohio, State Treasurer; Pennsylvania, State Treasurer; Texas, State Treasurer; Virginia, an individual citizen of Virginia designated by the state; West Virginia, State Treasurer; Wyoming, Secretary of State. Supplementary information supplied the Commission for Investors Syndicate.

⁹⁶ Derived from supplementary information supplied the Commission for Investors Syndicate.

A copy of the deposit agreement applicable to the deposits against certificate liability to residents of Massachusetts will be found in Appendix V.

g. New York Regulations

The regulation of the State of New York is applicable to Investors Syndicate Title & Guaranty Company, the New York subsidiary of the Corporation and not to the Corporation itself. This is true because since 1930 no business has been done in New York by the Corporation except through the subsidiary.

Investors Syndicate Title & Guaranty Company was incorporated under the insurance laws of New York as a title and guaranty corporation.⁹⁷ Among the statutory powers granted such corporations is the power to issue securities of various types, secured by real estate. Thus in the State of New York, Investors Syndicate Title & Guaranty Company carried on its business as a domestic company under the jurisdiction of the superintendent of insurance. Its investment certificates differ from those of the Corporation in that they are participations in mortgages on real estate bonds. The collateral to the certificates of the subsidiary is guaranteed as to principal and interest by the parent company. A reasonably broad power to require reports and to conduct examinations is reposed in the superintendent who also has the power to prescribe the terms of the contract or certificate.⁹⁸

The regulation by the authorities of New York of the subsidiary appears to be more rigid than the regulation by any other state of the parent.

Of historical significance is the fact that up to 1930, the Corporation itself sold its certificates in the State of New York. Having failed properly to qualify under the New York statutes, a dissatisfied certificate holder brought suit against the Corporation for a rescission of the investment contract and a return of the sums paid in. The Court found for the plaintiff and decreed a return of the payments.⁹⁹ Subsequently the New York subsidiary was acquired and commenced operations.

In a report by examiners to the Superintendent of Insurance of New York, dated December 3, 1937, certain statements and recommendations were made to which the Corporation excepted. Two of these exceptions are of particular interest in connection with the general subject of regulation—one touching on the question of custody of required deposits and the other relating to the status of the subsidiary as an insurance company.

The bill of exceptions filed by the Corporation contains the following statement:¹⁰⁰

1. On page 7 of the report it is stated:

"It is the opinion of your examiner that the securities underlying the certificates sold to investors in this state should be deposited in a financial institu-

⁹⁷ L. 1909, ch. 33; McKinneys Consolidated Laws of New York, Book 27, Art. 5, Sec. 170; Cahill's Consolidated Laws of New York, 1930, ch. 30, Sec. 170. This company also sells its certificates in Iowa and California, the regulation of which states have been previously discussed.

⁹⁸ Ibid. See also Public Examination, Investors Syndicate, at 21552, 21554.

⁹⁹ Reply to the Commission's questionnaire for Investors Syndicate, Item 20.

¹⁰⁰ Derived from supplementary information supplied the Commission for Investors Syndicate.

tion in New York City, which procedure would be similar to that now followed in the case of investors in the State of Iowa."

Deposits for New York certificates have been made with the Midland National Bank and Trust Company of Minneapolis, as Trustee, as required by the terms and conditions of such certificates and in accordance with the trust agreement with said trustee. This arrangement applies to all certificates sold to New York residents prior to May 15, 1935, and has been in force since June 16, 1930, almost eight years. The cost of maintaining the deposit under these trust agreements with the Midland National Bank and Trust Company of Minneapolis is much less than would be the case if the deposits were to be transferred to New York and the expenses in connection therewith are limited by the terms of the certificates themselves. Under these circumstances, the company feels that this arrangement should not be disturbed.

With respect to certificates issued since May 15, 1935, deposits have been made with a New York trustee as suggested by the report.

Further on in the bill of exceptions the company contends:

3. On page 14 the report contains the following statement:

"Said contracts also contain a provision for optional settlement in the event of death.

"The effect of this latter provision results in the certificates having a greater repurchase value than would be allowed in the absence of death and/or permanent disability and in the opinion of your examiner constitutes a type of insurance not provided for in the Corporate powers of the company."

This statement is excepted to on the ground that the provision referred to does not constitute insurance in any form and is not beyond the powers of the corporation. [Italics supplied.]

After citing judicial opinions in support of its contentions and analyzing the provisions, the discussion in behalf of the Corporation at this point concludes:

It seems perfectly clear that this is an agreement of rescission rather than an insurance provision. The purpose of these contracts is to provide a form of periodic investment. Upon death or disability, continuance of the contract on the part of the investor or his representative may become impossible or onerous. An option given to the investor or his representative either to continue the contract or to rescind is equitable and fair and bears no resemblance to life insurance.

It is significant that the amount payable bears no relationship to the assured's age. The investor's physical condition has no bearing upon the contract. The certificate is specifically stated to be assignable and by necessary implication the disability provisions are applicable to the assignee where it occurs after the company endorses the assignment upon the certificate. Obviously, no insurance policy could so provide. [Italics supplied.]

* * * * *

4. On Page 14 the report contains the following statement:

"In addition to the foregoing the contracts also provide for annuity payments, which likewise constitutes a form of insurance beyond the company's corporate powers."

This statement is excepted to on the ground that the certificates issued by the Investors Syndicate Title & Guaranty Company contain no provision for an annuity and are not beyond the powers of the corporation.

Section 9 of the Insurance Law provides:

"No corporation or individual shall transact in this state any business not specified in the certificate of authority granted by the Superintendent * * *."

The business of insurance within the meaning of this section shall include the issuance of all kinds of endowment policies and annuity contracts."

Paragraph 9 of the rights, terms, and conditions of the certificate currently issued by the Investors Syndicate Title & Guaranty Company provides:

"9. *Optional settlement privileges.*—Upon written order of the subscriber to the Company at any time after ten annual payments have been made by the Subscriber under the terms hereof, the Company agrees upon the purchase by it of the Subscriber's Undivided interest to pay to the Subscriber the amount to which he is entitled from such purchase in equal annual installments with interest thereon at the rate of $4\frac{1}{2}\%$ per annum credited annually. The Schedule on the following page specifically sets forth the amounts payable annually hereunder per thousand dollars. The Subscriber may elect, however, to receive the annual payments in semiannual, quarterly, or monthly installments and in such event the amounts shown in such schedule shall be divided by two, four, or twelve, as the case may be. The Subscriber may at any time during such period elect to receive, or the Company may elect to make, settlement for unpaid installments in one sum, the amount payable being the then present worth of the unpaid installments computed for the unexpired period at $4\frac{1}{2}\%$ per annum."

It is submitted that this paragraph of the certificate does not provide an annuity. The subscriber is the owner of the undivided interest. On its face the certificate provides: "the Subscriber, becomes the owner, in accordance with the terms hereof, when and as such payments are made, of an Undivided Interest in bonds or notes secured by First Mortgages on first trust deeds, hereinafter referred to as 'Securities.' * * *"

Paragraph 9 of the certificate quoted above merely provides that the company will purchase the Undivided Interest owned by the subscriber at the amount specified in the certificate. The nature of the provision is described by the Appellate Division of the Supreme Court in the case of *Pink vs. Investors Syndicate Title & Guaranty Company*, 246 App. Division 172, 285 N. Y. Supp. 155, and by the court of Appeals, in the same case in 6 N. E. Reporter, 2d Series, page 414. The language of Judge Heffernon of the Appellate Division of the Supreme Court found on Page 159 is as follows:

"The language of this Certificate discloses that it is a sale of an undivided interest in certain bonds or notes secured by mortgages deposited or to be deposited with the trustee. The purchaser of the certificate agrees to pay for the same or for his undivided interest over a period of years in monthly installment payments. The defendant (the company) agrees under certain conditions that upon demand by the owner and holder of the certificate and the surrender of this certificate to it, that defendant will repurchase at certain specified prices the undivided interest of the certificate holder."

The language of the Court of Appeals found on Page 415 is as follows:

"Such certificate evidenced the sale of an undivided interest in certain bonds or notes secured by mortgages deposited or to be deposited with a trustee. The purchaser of the certificate agreed to pay for the same over a period of years in monthly installments. The defendant agreed upon certain conditions, upon demand by the owner and holder of the certificate and its surrender, to repurchase at certain specified prices an undivided interest of the certificate holder."

Thus it appears that this provision constitutes an agreement for the sale by the subscriber of his undivided interest and for the purchase thereof by the company at a fixed price and merely gives the subscriber the right to take this purchase price in installments instead of in a lump sum. Certainly it cannot be contended that an agreement is an annuity simply because it provides for payment of the purchase price of a commodity or other form of property in installments instead of in a lump sum at the election of the seller.

APPENDIX X

PARTICULARS OF PROCEEDINGS AGAINST FIDELITY INVESTMENT ASSOCIATION

On December 14, 1938, the Securities and Exchange Commission filed an action for an injunction in the United States District Court for the Eastern District of Michigan, Southern Division, against Fidelity Investment Association, alleging that the defendant Corporation was engaged in acts and practices in the sale of its securities which constituted violations of the fraud provisions of the Securities Act of 1933 (Section 17 (a)). On the same day an order for the defendant to show cause was issued by Judge Edward Moinet and on December 22, 1938, the Association filed an answer to the bill which in general denied all allegations of impropriety. On the same day, December 22, with the defendant Association's consent a final judgment was entered enjoining the Association from engaging in the acts alleged in the complaint.

The bill of complaint is as follows:

DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF MICHIGAN

Civil Action—File No 281. Complaint

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF,

v.

FIDELITY INVESTMENT ASSOCIATION, A CORPORATION, DEFENDANT

I

It appears to the plaintiff that the defendant is engaged in acts and practices which constitute and will constitute violations of Section 17 (a) of the Securities Act of 1933, 15 U. S. C., 77q (a), and the plaintiff brings this action to enjoin such acts and practices.

II

Jurisdiction is conferred on the Court by Section 22 (a) of the Securities Act of 1933, 15 U. S. C., 77v (a).

III

Defendant was incorporated in West Virginia April 26, 1911, as Fidelity Investment Loan Association, a loan company. On November 22, 1912, it purchased the West Virginia annuity bond business of an Atlanta, Georgia, corporation in financial difficulties. Name was changed to Fidelity Investment Association and defendant, operating under a West Virginia statute, commenced the business of soliciting and receiving deposits and payments on contracts, certificates, and bonds calling for initial and monthly payments to defendant

by purchasers thereof, and providing for lump sum settlement by defendant at a specified future date after completion of payments or, at the option of the purchaser, periodic payment by defendant of definite amounts over a period of years.

IV

From November 9, 1920, to date defendant has issued and sold to the general public securities, namely, approximately 200,000 contract certificates (hereinafter more particularly described) for a total face amount of approximately \$600,000,000. On June 30, 1938, 112,542 of these certificates were outstanding for a total face amount of \$276,223,450. Each series of contracts sold calls for the creation and maintenance by defendant of Special Funds for the benefit of a particular class of contract holders, and calls for purchase and deposit in trust of underlying portfolio securities delimited by West Virginia statute, as hereinafter more particularly described.

To conceal defendant's failure to maintain required contract reserves; to conceal defendant's purchase and deposit of underlying portfolio securities which do not meet the requirements of the West Virginia statute; and to conceal very substantial impairment of and deficits in the various Special Contract Funds, defendant has resorted to interfund and intersubsidiary transactions, all in violation of the terms of the contract certificates issued by defendant, and in violation of the West Virginia and other State statutes under which defendant operates. Defendant has and is engaged in transactions, practices, and courses of business which operate, would operate, and did operate as a fraud and deceit upon the purchasers of the securities issued by it; has employed devices, schemes, and artifices to defraud; and has obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they were made, not misleading, all as explained in detail *infra*.

V

As at June 30, 1938, defendant, through its Agency Division and through its wholly owned subsidiary, Fidel Association of New York, Incorporated, maintained and now maintains 58 district offices in—

Allentown, Pa.	Detroit, Mich.	Pittsburg, Pa.
Atlanta, Ga.	Erie, Pa.	Pottsville, Pa.
Aurora, Ill.	Fairmont, W. Va.	Racine, Wis.
Baltimore, Md.	Glens Falls, N. Y.	Reading, Pa.
Battle Creek, Mich.	Grand Rapids, Mich.	Richmond, Va.
Bluefield, W. Va.	Green Bay, Wis.	Roanoke, Va.
Bridgeport, Conn.	Harrisburg, Pa.	Saginaw, Mich.
Buffalo, N. Y.	Huntington, W. Va.	Sandusky, Ohio.
Charleston, W. Va.	Louisville, Ky.	Savanna, Ill.
Chicago, Ill.	Milwaukee, Wis.	Scranton, Pa.
Cincinnati, Ohio.	Montgomery, Ala.	Sheboygan, Wis.
Cleveland, Ohio.	Nashville, Tenn.	St. Louis, Mo.
Columbia, Mo.	New Orleans, La.	Tarentum, Pa.
Columbus, Ohio.	New York, N. Y.	Toledo, Ohio.
Columbia, S. C.	Parkersburg, W. Va.	Uniontown, Pa.
Cumberland, Md.	Peoria, Ill.	Washington, D. C.
Dayton, Ohio.	Philadelphia, Pa.	

for the purpose of sale of its securities to the general public in the territories adjacent to said offices; advertises in newspapers and magazines having a national circulation; and maintains a staff of approximately 2,000 sales persons,

sale managers, supervisors, and division supervisors, whose remuneration was and is dependent upon commissions and overriding commissions, based upon the amount of securities sold.

Approximately 60,000 purchasers resident throughout the United States send and are continuing to send in their monthly payments regularly to defendant through the United States mails, or to district offices which, in turn, forward said payments to defendant through the United States mails. Defendant confirms sale of and forwards its securities through the United States mails, and sends monthly receipts and notices of payments due to all purchasers through the United States mails.

VI

Defendant operated and operates by virtue of and under the terms of Chapter 33, Article 9 of the West Virginia Code. Defendant is required to deposit with the West Virginia State Treasurer "in trust, for the benefit of its contract-holders" \$100,000 in approved securities and in addition, must maintain at all times a deposit with said State Treasurer of approved securities to an amount equal to the total amount which defendant may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of deposit, provided that when the laws of any other State require a deposit in that State for the benefit of contractholders in that State, credit is allowed for such deposits.

Bonds and securities eligible for deposit are by West Virginia statute limited to—

"bonds or obligations of the United States; or bonds of any state or any political subdivision thereof, (including bonds issued by the West Virginia Bridge commission); or bonds or obligations of any foreign government, or territorial possession thereof; or bonds of any private corporation secured by first mortgage or trust deed on its property; or debentures, notes, preferred or guaranteed stocks of a corporation whose net income applicable to payment of dividends for five years next preceding the date of their being offered for deposit shall have been equal to at least four per cent per annum on the par value on all its outstanding stock, or, in case its stock has no par value, then on the value at which such stock was issued; or bills and acceptances eligible for purchase by federal reserve banks; or notes or bonds secured by first mortgage or trust deed on improved real estate, to an amount not exceeding fifty per cent of its appraised value, if they be accompanied by proper abstract of title and fire insurance policy or policies to adequately protect the improvements on such real estate;"

Defendant may not deposit more than 10% of any preferred or guaranteed stock of any issuing corporation, and may not invest more than 10% of its assets in the securities of any one corporation. For failure to make additional deposits to cover liabilities, or when its liabilities exceed its assets, defendant's license to do business shall be revoked or suspended.

Statutory requirements preliminary to doing business in other States in which defendant operates include general qualifying deposits in fixed amounts of cash or designated securities and subsequent deposit of similar securities, against liabilities to contractholders in such States. Defendant represents in its selling literature "Securities Deposited With State Departments In Accordance With Legal Requirements Of Each State In Which We Operate."

No director or officer may receive any money or valuable thing for negotiating or recommending any loan from defendant or for aiding in the sale of any stocks, bonds, or other securities to defendant and no loan or investment may be made without either the approval of a majority of a committee of at least three directors empowered to make investments or the approval of a majority of the directors at a meeting of the directors. Every officer or di-

rector knowingly consenting to a loan or investment in willful violation of the West Virginia statute shall be personally liable for any loss sustained by such investment and such officer or director shall also be guilty of a felony. Any person violating any provision of this West Virginia statute shall be guilty of a misdemeanor.

VII

From August 12, 1913, to September 6, 1934, sales to the general public of securities issued by defendant were made through National Sales Agency, Inc., a West Virginia corporation, owned and controlled by one Fred M. King. National Sales Agency, Inc. habitually obtained large monthly advances from defendant in excess of actual earned commissions and against pledge of stock control.

From September 6, 1934, to date, all sales to the general public of securities issued by defendant are made by defendant's Agency Division, formed to take over certain functions, assets, and liabilities of National Sales Agency, Inc. As at September 6, 1934, the indebtedness of National Sales Agency, Inc. to defendant amounted to \$1,056,716.27 and was evidenced by National Sales Agency, Inc. notes. To maintain the semblance of value for said notes, defendant's Agency Division "operates exclusively for the benefit of National Sales Agency, Inc." and pays principal and interest on said National Sales Agency, Inc. notes, by virtue of payments received from defendant in amounts sufficient for said purpose. National Sales Agency, Inc. has been dormant since September 6, 1934, and has been for a number of years and now is insolvent, chief "assets" having been unsecured loans to Fred M. King, subsequently discharged in bankruptcy, and to sales personnel.

VIII

As of February 10, 1926, total capitalization of defendant equalled \$150,000, consisting of 1,500 shares of \$100 par value common stock. From February 10, 1926, to date, defendant has increased its capital represented by common shares by declaring and paying stock dividends in common stock totaling approximately 6,024 shares of a total par value of \$602,400 and by selling to the public 600 additional shares of a total par value of \$60,000, making total common capitalization 8,123 shares of a total par value of \$812,300.

On August 10, 1931, an issue of 5% cumulative preferred stock of a par value of \$100, with voting rights in the event of default of annual dividends, was authorized, in part to be offered to registered holders of outstanding contracts of defendant in exchange for the surrender and cancellation of said contracts at a stated valuation. From November 1931 to November 1932, a total of 5,051 preferred shares were sold or exchanged, having a total par value of \$505,100.

On December 23, 1936, a 50% stock dividend on common shares, payable in preferred shares, was paid by the issuance of 4,059 preferred shares of a total par value of \$405,900.

Of total capitalization as of December 31, 1937, \$752,517.01, including \$51,543.67 of premiums, was paid in by stockholders and \$1,022,326.66 par value of stock was issued as stock dividends.

IX

From November 9, 1920, through April 23, 1925, defendant issued and sold 38,504 Special Income Contracts for a total face amount of \$113,330,000. Sales

were made in Illinois, Pennsylvania, West Virginia, Indiana, and the District of Columbia. Unit \$2,000 face Special Income Contract calls for a \$60 initial payment and 126 monthly payments of \$10 each. Agency and underwriting fees, deducted from initial and first seven monthly payments, total \$126.

Defendant expressly agrees to create and maintain a Special Income Active Reserve Fund and to set aside in said Reserve Fund the balance of the payments received on said contracts, being such amounts as, together with interest at the rate of 5% thereon compounded semi-annually to maturity and at the rate of 5% annually thereafter, will at any time be not less than the total amount then payable under said contracts. Defendant further agrees to invest said Reserve Fund in approved securities and to deposit said securities in trust, in accordance with the laws of the State of West Virginia.

Any surplus resulting from said Active Reserve Fund established out of moneys paid in on Special Income Contracts and earnings thereon over and above the amount necessary to mature said contracts, belongs exclusively to the registered holders of said contracts.

After the initial and at least 36 monthly payments have been made, a Special Income Contract holder may surrender his contract and receive a Paid Up Special Income Contract, the reserve for which defendant agrees to improve at the rate of 5% semi-annually to maturity and at the rate of 5% annually thereafter. Defendant receives any excess earnings and accretions of the Special Income Paid Up Fund. It did not segregate from the Association's General Fund, a Special Income Paid Up Fund until September 30, 1937. As of December 31, 1937 and June 30, 1938, these Special Income Funds had very substantial deficits, based upon the market value of their underlying portfolio securities.

X

From April 23, 1925 through February of 1932, defendant issued and sold 81,843 Special Annuity Contracts for a total face amount of \$268,218,000. Sales were made in Illinois, Pennsylvania, West Virginia, Ohio, Michigan, Indiana, District of Columbia, Kansas, Virginia, Maryland, Tennessee, Missouri, Oklahoma, Florida, Connecticut, Kentucky, Delaware, New Jersey, Mississippi, Minnesota, South Dakota, North Dakota, Arkansas, Iowa, North Carolina, and Alabama. Unit \$2,000 face Special Annuity Contract calls for a \$60 initial payment and 126 monthly payments of \$10 each. Agency and underwriting fees, deducted from initial and all monthly payments, total \$104.

Defendant expressly agrees to create and maintain a Special Annuity Active Reserve Fund and to set aside in said Reserve Fund the balance of the payments received on said contracts, being such amounts as, together with interest thereon, compounded semi-annually at the rate of 4½% per annum, will at any and all times equal or exceed the amount of cash payment liabilities of the defendant under said contracts. Defendant further agrees to invest said Reserve Fund, less loans to contractholders, in approved securities and to deposit said securities in trust, as required by the laws of the State of West Virginia.

Any excess of the Special Annuity Active Reserve Fund resulting from earnings and accretions thereto until the dates fixed for surplus distribution, over and above the amounts required to mature said contracts, is surplus which belongs exclusively to the registered holders of said contracts.

Defendant further agrees, as of the date fixed for surplus distribution in each maturing Special Annuity Contract, to withdraw from the Special Annuity Active Reserve Fund a sum sufficient to mature or retire each said contract, such withdrawals to constitute a Special Annuity Maturity and Retirement Reserve Fund which, less any unpaid loans, shall be invested in approved securities

and deposited in trust, as required by the laws of the State of West Virginia, and improved at the rate of 5% compounded annually. The defendant shall receive any excess earnings and accretions of said Special Annuity Maturity and Retirement Reserve Fund.

Defendant originally created and maintained a separate Special Annuity Active Reserve Fund, but did not segregate from the Association's General Fund a Special Annuity Maturity and Retirement Reserve Fund until September 30, 1937. As of December 31, 1937, and June 30, 1938, these Special Annuity Funds had very substantial deficits, based upon the market value of their underlying portfolio securities.

XI

From March 1932 through June 15, 1934, defendant issued and sold 24,759 Income Reserve Contracts, Series A, for a total face amount of \$60,465,000. Sales were made in Illinois, Pennsylvania, West Virginia, Ohio, Michigan, Indiana, District of Columbia, Virginia, Wisconsin, Missouri, Maryland, Delaware, and Oklahoma. Unit \$2,000 face Series A contract calls for an initial payment of \$100 and 132 monthly payments of \$10 each. Agency and underwriting fees, deducted from initial and all monthly payments, total \$110.25.

The Association expressly agrees to create and maintain a Series A Active Reserve Fund and to set aside in said Reserve Fund the balance of payments received on said contracts, being such amounts as, together with interest thereon compounded quarterly at the rate of 4% per annum, will at any and all times equal or exceed the amount of cash payment liabilities of the defendant under said contracts. Defendant further agrees to invest said Reserve Fund, less loans to contractholders, in approved securities and to deposit said securities in trust, as required by the laws of the State of West Virginia.

Any current amount of excess over required accumulation, determined semi-annually on the basis of the cost or market value of the Reserve Fund assets, whichever is less, is surplus, one-half of which is allotted provisionally to Series A contracts in good standing as a class, and one-half of which is allotted to the Association and is withdrawn by it from time to time.

Defendant further agrees, as of the date fixed for surplus apportionment in each maturing Series A contract, to withdraw from the Series A Active Reserve Fund the required accumulation therefor, such withdrawals to constitute a Series A Maturity and Retirement Reserve Fund which, less any unpaid loans, shall be invested in approved securities and deposited in trust, as required by the laws of the State of West Virginia, and improved at the rate of 4% compounded quarterly. Defendant receives any excess earnings and accretions of the Series A Maturity and Retirement Reserve Fund.

Defendant originally created and maintained a separate Series A Active Reserve Fund, but did not segregate from the Association's General Fund, a Series A Maturity and Retirement Reserve Fund until September 30, 1937. As of December 31, 1937, and June 30, 1938, Series A Active Reserve Fund had a substantial deficit, based upon the market value of its underlying portfolio securities.

XII

From June 15, 1934, to date, defendant has issued and sold and is issuing and selling Income Reserve Contracts, Series B. Sales were and are made in Illinois, Pennsylvania, West Virginia, Michigan, Indiana, District of Columbia, Virginia, Wisconsin, Missouri, Maryland, Delaware, Florida, Kansas, Tennessee, South Carolina, and Louisiana. As of June 30, 1938, defendant issued and

sold 47,811 Series B contracts for a total face amount of \$102,126,250. Unit \$1,250 face Series B contract calls for 126 monthly payments of \$7.50 each and is available with or without insurance protection providing for automatic completion of unpaid installments upon the death of the purchaser thereof. Agency and Association fees with insurance total \$129.70 and without insurance total \$84.70.

Defendant expressly agrees to create and maintain a Series B Active Reserve Fund, "as a Special Fund, solely for the discharge of its liability upon its Income Reserve Contract, Series B" and to set aside in said Reserve Fund the balance of the payments received upon said contracts, being such amounts as, together with interest thereon compounded semi-annually at the rate of $4\frac{1}{2}\%$, will at any and all times equal or exceed the amount of cash payment liabilities of the defendant under said contracts. Defendant further agrees to invest said Reserve Fund, less loans to contract holders, in approved securities and to deposit said securities in trust, as required by the laws of the State of West Virginia.

Any current amount of excess over required accumulation determined semi-annually on the basis of the cost or market value of the Reserve Fund assets, whichever is less, is surplus, one-half of which is allotted provisionally to Series B contracts in good standing as a class, and one-half of which is allotted to the defendant and is withdrawn by it from time to time.

Defendant further agrees, as of the date fixed for surplus apportionment in each maturing Series B contract, to withdraw from Series B Active Reserve Fund the required accumulation therefor, such withdrawals to constitute, "as a Special Fund," a Series B Maturity and Retirement Reserve Fund which, less any unpaid loans, shall be invested in approved securities and deposited in trust, as required by the laws of the State of West Virginia, and improved at the rate of $4\frac{1}{2}\%$ compounded semiannually. The defendant shall receive any excess earnings and accretions of said Series B Maturity and Retirement Reserve Fund.

Defendant originally created and maintained a separate Series B Active Fund, but did not segregate from the Association's General Fund, other than by allocation of securities, a Series B Maturity and Retirement Reserve Fund until June 30, 1936. As of December 31, 1937, and June 30, 1938, these Series B Funds had substantial deficits, based upon the market value of their underlying portfolio securities.

XIII

From July 23, 1935, to date in Ohio, and from July 1, 1938, to date in Kentucky, defendant has issued and sold and is issuing and selling income Reserve Contracts, Series D. As of June 30, 1938, defendant issued and sold 10,457 Series D contracts for a total face amount of \$20,690,400. Unit \$1,200 face Series D contract calls for 120 monthly payments of \$7.50 each. Agency and Association fees total \$83.18.

Defendant expressly agrees to create and maintain a Series D Active Reserve Fund, "as a Special Fund, solely for the discharge of its liability upon its Income Reserve Contracts, Series D," and to set aside in said Reserve Fund the balance of the payments received on said contracts, being such amounts as, together with interest thereon compounded annually at the rate of 4%, will at any and all times equal or exceed the amount of cash payment liabilities of defendant under said contracts. Defendant further agrees to invest said Reserve Fund, less loans to contract holders, in approved securities and to deposit said securities in trust, as required by the laws of the State of West Virginia.

Any current amount of excess over required accumulation, determined semi-annually on the basis of the cost or market value of the Reserve Fund assets, whichever is less, is surplus, one-half of which is allotted provisionally to Series D contracts in good standing as a class, and one-half of which is allotted to the Association and is withdrawn by it from time to time.

Defendant further agrees, as of the date fixed for surplus apportionment in each maturing Series D contract, to withdraw from Series D Active Reserve Fund the required accumulation therefor, such withdrawals to constitute, "as a Special Fund," a Series D Maturity and Retirement Reserve Fund which, less any unpaid loans, shall be invested in approved securities and deposited in trust, as required by the laws of the State of West Virginia, and improved at the rate of 4% annually. Defendant shall receive any excess earnings and accretions of said Series D Maturity and Retirement Reserve Fund.

Defendant originally created and maintained a separate Series D Active Fund, but did not segregate from the Association's General Fund, other than by allocation of securities, a Series D Maturity and Retirement Reserve Fund until June 30, 1936. As of December 31, 1937 and June 30, 1938, these Series D Funds had substantial deficits, based upon the market value of their underlying portfolio securities.

XIV

Defendant guarantees payment on all contracts issued by it. For this purpose, in addition to the various contract funds described above, defendant has created and maintains a general or stockholders' fund. Qualifying deposits in various States must be from the Association's General Fund.

As of December 31, 1937 and June 30, 1938, the General Fund showed a capital impairment based upon the market value of the underlying portfolio securities, substantially all of which were and are pledged with the State of West Virginia for the purpose of making up deposit deficiencies of the various Contract Funds.

XV

For the purpose of selling securities to the general public in New York, Connecticut, and New Jersey, defendant has created and maintains a wholly owned subsidiary, Fidel Association of New York, Incorporated.

From June 1932 through December 1934, Fidel Association of New York, Incorporated issued and sold 4,507 Collateral Trust Bonds, Series A, for a total face amount of \$12,682,000. From January 1935 to date, Fidel Association of New York, Incorporated has issued and sold and is now issuing and selling Collateral Trust Bonds, Series B. As at June 30, 1938, 4,518 Collateral Trust Bonds, Series B were issued and sold for a total face amount of \$10,487,500. Said Collateral Trust Bonds, Series A and B are substantially identical with Fidelity Investment Association Income Reserve Contracts, Series A and B, described in paragraphs XI and XII, *supra*.

Defendant in writing unconditionally guarantees the full and faithful performance by Fidel Association of New York, Incorporated, of all of its obligations under said Collateral Trust Bonds, Series A and B. This unconditional guarantee is a security by virtue of definition under the Securities Act of 1933. Defendant's General Fund is charged with the performance of said guarantee.

XVI

Within the past three years, defendant has created and now maintains three separate wholly owned subsidiary corporations: Paull Company, Marston Cor-

poration, and Marietta Company (formerly known as Pau-Mar Corporation), all West Virginia corporations.

Paull Company and Marston Corporation took over and acquired from certain Contract Funds and from the General Fund real estate and real estate securities, most of which were and are in various stages of default, and the National Sales Agency, Inc., notes, described in paragraph VII, *supra*. In exchange therefor, the subsidiaries issued their respective collateral trust bonds in a face amount identical with the book figures at which said real estate, real estate securities, and National Sales Agency, Inc., notes were being carried on the books of the Association, which book figures greatly exceeded the market value at date of transfer, and greatly exceed present market value.

Marietta Company has taken over certain real estate originally transferred to Paull Company and Marston Corporation and, through cash advances made by defendant, has financed the acquisition and construction cost of defendant's new Home Office Building. Marietta Company has issued a small amount of its securities and is to issue further securities in exchange therefor.

XVII

Upon information and belief:

From May 27, 1933, defendant—in the sale of securities issued by it—by redate and otherwise, namely, Special Income, Special Annuity, Income Reserve Series A, Income Reserve Series B, and Income Reserve Series D Contracts and Fidel Association of New York, Incorporated, Collateral Trust Bonds Series A and Series B guarantees, all described in paragraphs IX through XVI, *supra*, by the use of means and instruments of transportation and communication in interstate commerce, and by the use of the mails, directly and indirectly has engaged and is now engaging in transactions, practices, and courses of business which operate, would operate, and did operate as a fraud and deceit upon the purchasers of said securities, in that defendant as a regular practice in selling said securities intended to and did—

(1) Fail to purchase and deposit in trust sufficient bonds and other securities, as required and delimited by the laws of the State of West Virginia (described in paragraph VI, *supra*) and by the terms of the various contract securities (described in paragraphs IX through XIII, *supra*) issued by defendant;

(2) Purchase and deposit with the Treasurer of West Virginia bonds and other securities in default or which did not and do not meet the requirements of the above-described West Virginia statute;

(3) Fail to maintain at all times a sufficient deposit with the Treasurer of West Virginia and with other State officers and agencies, as required by the laws of said States and by the terms of the contract securities issued by defendant;

(4) Deposit, in States requiring deposit, securities belonging to Special Contract Funds in excess of the liability of said funds to contract holders residing in said States; using the excess to cover in part or wholly the liabilities of other Contract Funds; although representing to prospective purchasers: "Securities deposited with state departments in accordance with legal requirements of each state in which we operate";

(5) Deposit with the Treasurer of West Virginia portfolio securities purchased with moneys of specific Contract Funds, without requiring physical segregation of said securities as to said specific Contract Funds;

(6) Fail to segregate and apply separately cash payments received from specific classes of contract holders; and, commingling said cash payments, has permitted defendant's General Fund and certain Contract Funds to overdraw cash in very large amounts from other Contract Funds, said overdrafts at times totaling in excess of \$5,000,000, with and without interest allowances, and in violation of contract and statutory requirements as to investment and deposit;

(7) Through its General Fund, create, maintain, and operate a margin trading account in speculative securities while at the same time overdrawing cash for defendant's General Fund from specific Contract Funds;

(8) Fail to maintain at all times the required reserves against existing contract liabilities, and fail adequately to restore by contribution from the General Fund deficiencies existing at various times in specific contract funds;

(9) Fail to provide out of surplus and undivided profits or current earnings, reserves for depreciation and against loss on sale of securities and for contingencies;

(10) Transfer to defendant's General Fund approximately \$400,000 of "Gains on Terminated Contracts—Annuity" which, from 1925 through 1937, had accumulated as accretions to the Special Annuity Active Fund, recognized as belonging exclusively to "persistent" annuity contract holders; by means of book-keeping entries, effect the "sale" or transfer of securities between Contract Funds and between Contract Funds and the General Fund, usually at prices substantially in excess of the then book value of the securities transferred; increasing the so-called "cost" of the securities and the "profits" of said funds by well over \$1,000,000, as of December 31, 1937, and materially affecting the mechanics of evaluation for the purpose of surplus distribution;

(12) Create a General Fund "earned surplus" out of moneys or "profits" made available by the practices described in subparagraphs (8), (9), (10), and (11), *supra* (failure to restore deficiencies in Contract Reserves; failure to provide reserves for contingencies; transfers of "Gains on Terminated Contracts—Annuity"; writing up of book value of securities through interfund transfers), and, out of said surplus, declare and pay dividends to both common and preferred stockholders of defendant;

(13) Through its investment committee and directors, purchase with moneys of Contract Funds and the General Fund securities in so-called "Special Situations," in which officers, directors, and members of the investment committee of defendant were interested in capacities other than in connection with their duties to defendant Association, and, in at least one instance, to the personal benefit of various officers and directors of defendant.

XVIII

Upon information and belief:

From July 15, 1936, defendant, in the sale of the above-described securities issued by it, by the use of means and instruments of transportation and communication in interstate commerce, and by the use of the mails, directly and indirectly, has employed and is now employing devices, schemes, and artifices to defraud the purchasers thereof, in that defendant created and now maintains wholly owned subsidiaries; namely, Paull Company, Marston Corporation, and Marietta Company, having represented to various State agencies that said subsidiaries would be liquidating companies to take over and liquidate certain real estate and real estate securities, whereas actually, as is more particularly described in paragraph XVI, *supra*, defendant organized said subsidiaries and transferred certain questionable assets thereto—

(1) To conceal the indebtedness of the insolvent and dormant National Sales Agency, Inc. to the General Fund and to the various Contract Funds;

(2) To conceal from the general public the investment of moneys of the Association and of the various Contract Funds in certain real estate and real estate securities, most of which were and are in default, and which were being carried at a book value greatly in excess of the then market value;

(3) To create the semblance of depositability for and to increase the West Virginia deposit value of the above described holdings by approximately \$1,500,000, through the substitution therefor of "collateral trust bonds" issued by said wholly owned subsidiaries;

(4) To permit the continued purchase and indirect deposit with West Virginia of defaulted and speculative real estate issues and securities ineligible for deposit according to the laws of West Virginia by having such subsidiaries purchase said defaulted and ineligible securities and issues such "collateral trust bonds" in exchange therefor;

(5) To facilitate transfer of notes receivable and defaulted real estate securities between Contract Funds and the General Fund at prices higher than market by substituting "collateral trust bonds" at the "book value" of said securities and transferring such bonds at "book" or "cragin" values, higher than market;

(6) To obtain from the various Contract Funds moneys for the erection of a new Home Office Building by selling said Funds preferred stock and other securities issued by Marietta Company; and to enable defendant to carry said new Home Office Building on the books of defendant as "bonds" or "other securities", rather than as "real estate."

XIX

Upon information and belief:

From December 31, 1936, defendant, in the sale of the above-described securities issued by it, by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly, has obtained and is now obtaining money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, in that defendant represented and caused to be represented to prospective purchasers, through the means of financial statements in pamphlet form, attached hereto and marked Exhibits A, B, and C; through national advertising; and through its sales personnel—

(1) That certain financial statements (Exhibits A, B, and C) duplicated in "credit files", national advertising and sales literature supplied to all sales persons and to active contract holders, were and are true, whereas in truth and in fact, said financial statements, as defendant well knew, are false and misleading and their use withholds and suppresses material facts, as defendant was informed by its own auditor, as per Exhibit D attached hereto and made a part hereof;

(2) That the "assets" of defendant are in excess of sums variously represented to be from \$30,000,000 to \$37,000,000, whereas in truth and in fact, said sums, for the most part, represent a combination of "assets" segregated in and belonging to Special Contract Funds which are restricted for the exclusive benefit of specific classes of contract holders, as segregated;

(3) That "Reserves for Contract-Owners" are common funds similar to reserves required for insurance companies and generally available for the benefit of all policyholders, whereas in truth and in fact, by virtue of the terms of the contract certificates issued by defendant, said "Reserves" are, for the most part, restricted for the exclusive benefit of specific classes of contract holders;

(4) That Exhibits A, B, and C are consolidated financial statements of defendant Association, whereas in truth and in fact said Exhibits are in no way consolidated statements, but are essentially very condensed combined statements of Contract and General Funds, with investment in wholly owned subsidiaries only partially eliminated, and, as the defendant well knew, with use of said statements concealing large cash overdrafts in various Funds and the nature of the underlying assets of three wholly owned subsidiaries;

(5) That bonds, preferred stocks and other securities are valued at "cost" or amortized value, without disclosing that said "cost" is a book value in many instances artificially inflated by a selective process of interfund transfers;

(6) That the "consolidated" investment of defendant in real estate is but \$50,000; and that the balance of defendant's investments and the investments of the various Contract Funds are in highest grade liquid bonds, whereas in truth and in fact, defendant's real estate holdings, through its wholly owned subsidiaries, are very substantially in excess of \$50,000; and in truth and in fact, as the defendant well knew, a very substantial portion of the remaining investments of defendant and of the various Contract Funds are not in high grade liquid bonds;

(7) That the contract funds have always earned their required contract yields and have built up substantial surpluses, whereas, in truth and in fact, certain Contract Funds have not earned and are not earning their required contract yields and have substantial deficits; and, in truth and in fact, a very substantial percentage of the assets of defendant and of the various Contract Funds are securities which have no yield, or which have limited earnings which do not approximate the required contract yields;

(8) That defendant has never missed a maturity and has never borrowed from an outside source to meet its obligations, but omitted to state that maturities were in part met by defendant's conversion of maturing and matured contracts into preferred stock and into new contracts and paid up contracts issued by defendant; by defendant's persuasion of matured contract holders to accept delayed settlements, rather than lump sum cash payment; by profits from defendant's loan margin trading account; and by defendant's practice of very large cash overdrafts or borrowings between contract funds, at times exceeding \$5,000,000;

(9) That the costs attached to contract certificates issued and sold by defendant are nominal, or that there are no costs and deductions, whereas in truth and in fact, as defendant well knew, agency, underwriting and other costs attached to said certificates are very substantial and are to a very large extent deducted from the early payments by contract holders, as outlined in paragraph IX through XIII, *supra*, and in Exhibit E, attached hereto and made a part hereof;

(10) That insurance protection in Series B Contracts with insurance is furnished without cost to the contract holder, whereas in truth and in fact, the contract holder pays \$45 out of his deposits for insurance protection;

(11) That the full contract face amount is paid to the purchaser shortly after completion of required deposits, whereas in truth and in fact, said amount represents the aggregate of an optional installment settlement extending more than ten years after completion of required deposits;

(12) That contract holders may withdraw their full deposits at any time after one, two, or three years, whereas in truth and in fact, the contract-holder may not withdraw a sum equivalent to the aggregate of his deposits before the 109th monthly deposit on Series B Contract with insurance, or the 89th month without insurance, or before the 95th month on a Series D Contract;

(13) That defendant pays 4% to 5% on all moneys deposited with it by contract holders, and that defendant's contracts are better than savings bank deposits and United States Baby Bonds, whereas in truth and in fact, as defendant well knew, depending upon whether the immediate lump sum or the ten annual income coupon settlement is chosen by contract holders, average yield after completion of all required payments on Series B Contracts ranges from 1.55% to 3.38%, and on Series D Contracts ranges from 2.05% to 2.86%; and as explained in subparagraph (12), *supra*, there is no yield to the contract holder before the 109th, 89th, or 95th monthly deposit.

XX

Upon information and belief:

Unless enjoined and restrained therefrom, defendant will continue the acts and practices herein described.

WHEREFORE, the plaintiff demands—

(1) That the defendant, its agents, servants, representatives, and employees be enjoined and restrained during the pendency of this action and perpetually thereafter from, in the sale of securities issued by defendant, namely Special Income, Special Annuity, Series A, Series B, and Series D Contracts, and Fidel A and B Guarantees, or any other securities, by the use of means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly,

(a) Engaging in transactions, practices, or courses of business which would operate or do operate as a fraud or deceit upon purchasers, particularly

1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements, or

2. Failing to segregate and maintain at all time sufficient statutory deposits against appropriate liabilities, or

3. Failing to create and maintain separate contract reserve funds; or comingling cash receipts; or permitting cash over-drafts between various contract funds, or

4. Failing to maintain required reserves or to restore deficiencies in specific contract reserves, or

5. Engaging in margin trading accounts, or

6. Transferring to defendant's General Fund gains belonging to Contract Funds, or

7. Increasing "cost" of securities and "profits" of various funds by a selective process of interfund transfer of securities, or

8. Creating questionable "earned surpluses," and paying dividends therefrom, or

9. Purchasing securities in so-called "special situations," to the personal benefit of officers, directors, and employees of defendant, or any other acts or practices that would and do operate as a fraud or deceit upon purchasers similar to those specifically set forth above or of a similar purport or object.

(b) Employing a device, scheme, or artifice to defraud, particularly in the creation and maintenance of wholly owned subsidiaries to conceal the nature of certain indebtedness and investments, to artificially increase deposit values and avoid statutory deposit requirements, and to facilitate interfund transfers of notes and securities at prices other than market, or employing any other device, scheme, or artifice to defraud purchasers, similar to those specifically set forth above or of a similar purport or object.

(c) Obtaining money or property by means of untrue statements of material facts or omissions to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they are made, not misleading, concerning—

1. The truth of financial or other statements which withhold or suppress material facts;

2. The extent and availability of "assets" of defendant and of the various Contract Funds;

3. The extent and availability of contract reserves;

4. The "cost" of certain portfolio securities, the book value of which is enhanced by interfund or other transfers;

5. The rating, nature, and liquidity of the investments of defendant and of the various Contract Funds;

6. The yield, earnings, and financial condition of defendant and of the various Contract Funds;

7. The means used by defendant to meet contract maturities, and the extent of borrowings by defendant;

8. The costs attached to securities issued and sold by defendant, and their incidence;

9. The amounts payable to or withdrawable by contract holders;

10. The yield paid by defendant to contractholders or any other untrue statements of material facts or other omissions to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they are made, not misleading, similar to those specifically set forth above or of similar purport or object.

(2) For such other and further relief as is just.

(S.) CHESTER T. LANE,
Chester T. Lane,
General Counsel,

(S.) O. JOHN ROGGE,
O. John Rogge,
Assistant General Counsel,

(S.) ROBERT E. KLINE, JR.,
Robert E. Kline, Jr.,
Assistant General Counsel,

(S.) JOHN T. CALLAHAN,
John T. Callahan,
Assistant General Counsel,

(S.) EDWARD C. JAEGERMAN,
Edward C. Jaegerman,

(S.) MILTON R. KROOPF,
Milton R. Kroopf,
Attorneys for Plaintiff.

P. O. address: % Securities and Exchange Commission, 851 Federal Building, Detroit, Michigan.

STATE OF MICHIGAN,

County of Wayne, ss:

EDWARD C. JAEGERMAN, being duly sworn, deposes and says:

That he is one of the attorneys for the Securities and Exchange Commission, Plaintiff herein; that he has been duly authorized by said Plaintiff to make

this affidavit for it and in its behalf; that he has read the foregoing Complaint, knows the contents thereof, and knows that the facts therein set forth are true, except such facts as are therein stated upon information and belief, and that such allegations on information and belief, he believes to be true.

That the source of deponent's knowledge and information and the grounds of his belief are investigations made and conducted by deponent as attorney herein for the Plaintiff herein, in charge of this matter with attorney John T. Callahan, and the testimony of witnesses examined by deponent and John T. Callahan in hearings held in this action, before deponent and John T. Callahan as officers of the Securities and Exchange Commission.

(S.) EDWARD C. JAEGERMAN,
Edward C. Jaegerman,
Attorney.

Subscribed and sworn to before me this 14th day of December, 1938.

(S.) JOHN H. GROGAN, *Notary Public.*

My commission expires March 21, 1939.

EXHIBIT D

WILSON AND CROSS,
CERTIFIED PUBLIC ACCOUNTANTS,
Plain Dealer Building,
Cleveland, Ohio, January 27, 1938.

Mr. A. L. KING,
Vice President and Comptroller,
Fidelity Investment Association,
Wheeling, West Virginia.

DEAR SIR: This is not a Wilson & Cross letter but a communication from me personally.

You have requested, and we have furnished, a combined balance sheet of the Fidelity Investment Association and the Fidel Association of New York, Inc. It is my understanding that the same may be used for public purposes as representing the financial condition of the Fidelity Investment Association at December 31, 1937.

I want to disclaim any connection and advise against the use of such a combination of figures for such a purpose.

My reasons follow:

1. I do not believe that the financial condition of Fidelity can be shown by anything but a consolidated statement including all the subsidiaries.
2. Use of the statement furnished will withhold or suppress material facts.
3. Use of the statement is bad sales psychology. For instance: Most people of Wheeling know of Fidelity's interest in fee, or by mortgage or real estate mortgage bonds, in various parcels of real estate. Failure to disclose these interests in real estate certainly must cause question among those who know the facts and read the statement.
4. I want no part in any "window dressing".

I feel this formal letter to you on this subject is necessary to guard against possible future injury to my professional reputation. I cannot afford to go along in a matter which I do not believe nor do what I have in many investigations criticized and assisted in the prosecution of others.

Yours very truly,

(S.) HERBERT B. CROSS,
Certified Public Accountant (Ohio).

HBC:KL

Among the supporting affidavits filed were those of members of the Commission's staff. These affidavits were as follows:

DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN
DISTRICT OF MICHIGAN

Affidavit

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

FIDELITY INVESTMENT ASSOCIATION, DEFENDANT

STATE OF MICHIGAN,

County of Wayne, ss:

JOHN T. CALLAHAN, being duly sworn, deposes and says:

I am an attorney for the Securities and Exchange Commission. In an order issued by the Commission on May 17, 1938, Edward C. Jaegerman and I were designated as officers of the Securities and Exchange Commission to make an investigation of the Fidelity Investment Association (hereinafter referred to as defendant) and its wholly owned subsidiary, Fidel Association of New York, Incorporated.

Pursuant to the order, I directed, among other things, an investigation of defendant's salesmen and contract holders who had purchased Income Reserve Contracts of the Fidelity Investment Association.

That such investigation was conducted in Philadelphia, Pa., Pittsburgh, Pa., Cleveland, Ohio, Chicago, Illinois, and Detroit, Mich.

That I examined salesmen of the Fidelity Investment Association under oath in Philadelphia, Pa., Chicago, Illinois, and Detroit, Michigan.

That attached to the Order to Show Cause are ten affidavits representative of the type of statements made to the public in the sale of contracts sold by the defendant's salesmen.

That the following are some of the principal misrepresentations and statements made misleading because of omissions to state material facts in the sales representations made to prospective contract holders and contract holders, based on the sworn statements of salesmen:

(1) That the Fidelity Plan is a systematic form of savings similar to depositing money in a savings institution.

(2) That depositing money with Fidelity is as safe as depositing money in a savings bank and contract holders are so informed.

(3) That Series B and D Contracts are guaranteed, the investor being guaranteed against loss. The principal and interest is also guaranteed and fixed.

(4) That deposits made with Fidelity Investment Association are absolutely safe and that such moneys are deposited in trust with the said Fidelity Investment Association.

(5) That the Fidelity Investment Association operates under the insurance laws of the State of West Virginia and other states in which it does business.

(6) That Fidelity is regulated like any other insurance company doing business in West Virginia.

(7) That in the various funds or series of contracts set up by Fidelity there can be no shifting of funds from one series or type to another, nor can there be any commingling of funds from one series to another or loans made from one series to a series of another fund.

(8) That there can be no purchase or sale of securities from one fund to another whereby one series' fund would benefit and another suffer a loss because it would be inequitable and contrary to the principle of the Fidelity Investment Association.

(9) That the securities purchased in the investment portfolio of the Fidelity Investment Association are approved by the Insurance Commissions of the States of West Virginia and New York largely and are under the supervision of the Insurance Commissioners of those two states.

(10) That the only type of securities purchased with the contract holders' money is Grade A or better and contract holders are so told.

(11) That Fidelity has to be 100% liquid, according to the law of the State of West Virginia.

(12) That Fidelity Investment Association does not engage in the purchase of real estate mortgages or securities of doubtful value and, in fact, the only real estate it owns is the home office building at Wheeling, West Virginia, which is carried at \$50,000.

(13) That the law of the State of West Virginia requires the Fidelity Investment Association to have at all times gilt-edge securities approved by the State of West Virginia on deposit covering 100% guarantee of every contract liability due and owing to the contract holder.

(14) That securities held on deposit are valued at market prices and if one stock goes down, there must be another one to replace it so that the market value at all times is 100% of the contractual liability due and owing to the contract holder.

(15) That from 1911 up to the present time the Fidelity Investment Association has sold several series and types of contracts to thousands of investors throughout the country and those contracts have always earned their requirements.

(16) That Fidelity has no investments in default of either principal or interest.

(17) That where surplus payments are to be made to contract holders, the contract holders receive 50% and Fidelity 50% and both share equally and at the same time.

(18) That the Fidelity Investment Association cannot share ahead of the contract holder in the disbursement of any surplus participations but must share with him because otherwise it would be inequitable.

(19) That total fees and charges to be deducted from payments made by contract holders in the purchase of Fidelity Investment Association contracts are nominal, without disclosure of said fees and charges.

(20) That when financial statements are used, it is done to convince the purchaser that defendant has no frozen assets except the real estate which is listed at \$50,000 and is the only real estate that Fidelity has in its portfolio.

(21) That each series of funds issued by the Fidelity Investment Association has its own surplus and that each series of funds has more than earned its requirement.

(22) That it has always been the policy of the Fidelity Investment Association to have contract holders complete their payments without interference from the Association so that at maturity the contract holder would get the full benefits and profit from the contract.

(23) That Fidelity has at all times set up reserves immediately from moneys received from contract holders under each series of contracts sold for the purpose of meeting its obligations to the contract holder.

(24) That the special law under which Fidelity operates in West Virginia is supposed to be as stringent a law as there is in any state of the Union, and that, for the protection of its contract holders, the Association adheres to the strict letter of the law in observance of the conditions under which it operates.

(25) That securities purchased for the investment portfolio are termed at least Grade A bonds and the procedure covering the purchase of securities is the same as that used by the better insurance companies operating under the Massachusetts law.

(26) That the preferred stocks purchased are listed as Grade A and the common stocks purchased would also have to have a Grade A rating because that is in line with the policy of the Association.

(27) That Fidelity Investment Association does not engage in the speculation of securities because it would be prohibited from doing so under the special act under which it operates.

(28) That Fidelity Investment Association absolutely does not engage in the purchase of any frozen assets with contract holders' money, nor does it engage in the purchase of real estate securities or mortgages of doubtful value.

(29) That the income a contract holder would receive from Fidelity on Series B Contracts would be greater at maturity than the amount he would receive from a savings account.

(30) That Fidelity has earned money each year from its business operations.

(31) That the investment portfolio of Fidelity shows that during the last ten years a little in excess of 5% has been earned annually, and that such information was received from one of the officers of the Fidelity Investment Association.

(32) That each series of contracts sold by the Fidelity Investment Association has a surplus which is substantial.

(33) That securities are deposited by Fidelity Investment Association with the various state departments and in accordance with the legal requirements of each state in which it does business.

(34) That in addition to the exacting laws of the State of West Virginia, Fidelity must and does comply with individual state laws to safeguard the funds of others.

(35) That Fidelity has the same type of securities and has as strong an investment portfolio as the better class of insurance companies.

(36) That the Fidelity Investment Association does not attempt to realize any profit whatsoever from the insurance that a contract holder purchases in a self-completing plan.

(37) That the representations contained within the financial statements of Fidelity Investment Association as of December 31, 1937, and June 30, 1938 are absolutely true statements which can be relied upon by the purchasers.

(38) That Annuity, Series A and Series B Contracts have been earning their requirements, as have the contracts previously issued by Fidelity.

(39) That the Association does not engage in the purchase of any speculative issues with contract holders' moneys because it is prohibited from doing so by the laws of West Virginia and that such a practice is also prohibited in the various other states in which the Association operates.

(40) That each series of contracts sold by Fidelity is segregated by funds, and there are no interfund switches; the moneys received from each series of contracts sold stand on their own strength without any help or assistance from any other fund.

(41) That the portfolio earnings of Fidelity for the year 1937 was 4.87% and for the previous year 5.02%.

(42) That 100% of every obligation due and owing to contract holders is on deposit with the States of West Virginia, Illinois, and other states, and the amounts actually on deposit are in excess of the contractual obligations.

(43) That the valuation of securities on deposit is based on market values.

(44) That Fidelity purchases preferred stocks only where there is no previous bond issue ahead of said preferred stock, obviating any prior obligation.

(45) That no common stocks are held in Reserves, for the benefit of contract holders.

(46) That as a further safeguard to investors, bonds purchased by the Association are bought on option and then after thirty days, the Association can return them or cancel the order, giving wider protection to contract holders if there is something wrong with the securities purchased.

(47) That Fidelity has earned money from 1926, earning from 5% to 5½% annually.

(48) That Fidelity has its own Special Fund and Reserves for each series of contract sold and each has a substantial surplus.

(49) That "savings" with Fidelity connotes retention of principal at all times and safety of principal.

(50) That Fidelity can return securities purchased in ninety days if it does not want them; or in case anything should develop that may have been overlooked, the Association has a 90-day clause in which it can withdraw from the contract with the various dealers and brokers from whom the securities were purchased.

(51) That Fidelity is doing business in 26 or 27 states and is subject to audit by auditors of those states who visit the Association right along.

(52) That Fidelity made money through the depression which, to a large extent, was due to the excellent investment committee and staff of experts.

(53) That securities on deposit in the State of West Virginia and other states in which the Association conducts business are valued only at the market price.

(54) That for the year ending December 31, 1937, Fidelity earned 4.87% on its portfolio; for the year ending December 31, 1936, it earned 4.36%; and for the year ending December 31, 1935, it earned 4.88%.

That the following are some of the principal misrepresentations and statements made misleading because of omissions to state material facts, based on sworn statements received from contract holders:

(1) That the officers of the Fidelity Investment Association work without salaries and only receive commissions for their work.

(2) That the Association is a safe, sound financial institution and is, in fact, stronger financially than any insurance company, because it is not cluttered with real estate.

(3) That it had on deposit securities at market value dollar for dollar of the amount deposited by contract holders.

(4) That the plan is a systematic form of savings, like depositing money in a savings bank, only the investor would receive a larger interest return on his investment.

(5) That the Fidelity Investment Association operates under the insurance laws of the States of West Virginia, Illinois, Michigan and other states in which it conducts business and is regulated like any other insurance company operating in those states.

(6) That the Association is vigorously examined by the various state departments in which it conducts business.

(7) That Fidelity is fully liquid at all times and does not engage in the purchase of frozen assets or the purchase of real estate mortgages of doubtful value.

(8) That the Fidelity Investment Association from the time it began to operate in 1911 up to the present time has issued several series or types of contracts to thousands of contract holders situated throughout the country, and that those contracts have always earned their requirements.

(9) That securities are on deposit with the State of West Virginia dollar for dollar of the amount invested by contract holders.

(10) That the valuation of securities is determined by present market values, which is an additional safeguard to all investors holding contracts.

(11) That the total fees and charges deducted from payments made by contract holders are very small.

(12) That securities are deposited with the various state departments, in accordance with the legal requirements of each state in which the Fidelity Investment Association operates.

(13) That it has always been the policy of the Fidelity Investment Association to have contract holders continue to make their monthly payments without any interference from the Association, in order to complete final payment and then receive the full benefits accruing to them from the contracts purchased.

(14) That it has always been the policy of the Fidelity Investment Association to set aside Reserves immediately from moneys received from contract holders, in order to meet its obligations to them.

(15) That by depositing \$7.50 monthly for a period of 10½ years, the contract holder will receive \$1,250 at the end of said period of time, and that such payment would be made in cash.

(16) That Fidelity is as strong financially as any insurance company.

(17) That contract is guaranteed as to both principal and interest, in which the investor cannot lose and is 100% safe.

(18) That the money is absolutely safe, because it is deposited in trust with the Fidelity Investment Association.

(19) That the moneys received from investors are reinvested by Fidelity Investment Association in Grade A securities which are 100% good.

(20) That the contract holder will receive 4% annually on the entire amount of money deposited by him in the purchase of a Series B Contract.

(21) That the Fidelity Investment Association has earned money each year from its business operations.

(22) That the reliability of the Fidelity Investment Association can be checked by going to the president of any bank to draw a credit report showing the financial standing of the Association.

(23) That the Fidelity Investment Association reinvests the moneys received from depositors in Government Bonds and Railroad Bonds, and purchases the same type of securities as other leading insurance companies, such as the Metropolitan Life Insurance Company and the Equitable Life Insurance Company of New York.

(24) That Fidelity does not have any frozen real estate assets, as other life insurance companies have.

(25) That each series of contracts sold by the Fidelity Investment Association has its own separate funds and each type of contract has a substantial surplus.

(26) That the Fidelity Investment Association never failed to meet a payment at maturity to contract holders and always made those payments in cash.

(27) That the Fidelity Investment Association is in fact somewhat like a mutual insurance organization, in that the principals operate for little or no profit other than the commissions paid to them.

(28) That the Series B Contract has earned money each year and, in addition to the maturity payments, a surplus participation is and will be prorated amongst contract holders at maturity.

(29) That the Fidelity Investment Association does not engage in any speculation, because the laws under which it operates prohibit it.

(30) That the company is 100% liquid at all times.

(31) That the Association does not engage in the purchase of any frozen assets, including real estate or real estate bonds and mortgages.

(32) That securities were and are on deposit with the States of Illinois, West Virginia, and other states in which Fidelity transacts business, dollar for dollar of the amount invested by contract holders.

(33) That such securities were and are valued at market value and that gives investors an additional safeguard.

(34) That Fidelity has no investments in default of either principal or interest.

(35) That Fidelity could only go bad if the United States Government went bad, the Association being that strong.

(36) That there is no extra charge for insurance, as it is a free service, being extended to the investors by the Association.

(37) That Fidelity is stronger financially than any insurance company, because it has on deposit dollar for dollar of the amount of money received from investors, which no insurance company has, because of the frozen condition of some of its assets.

(38) That contract holders could withdraw the amount of money they deposited with the Fidelity Investment Association dollar for dollar at any time.

(39) That Fidelity purchases only the soundest and safest type of securities, and that as an added safeguard the state laws under which it operates require it to do so, which acts as a safety feature to investors.

(40) That contract holders would receive $4\frac{1}{2}\%$ of the total amount of moneys deposited in the purchase of Series B Contracts.

(41) That by depositing \$7.50 monthly for a period of $10\frac{1}{2}$ years, a contract holder would receive at the end of that time a lump sum of \$1,250, together with a surplus participation resulting from earnings of the company.

(42) That there is no extra charge for insurance; that it is given gratis as a service extended to purchasers of Series B Contracts.

(43) That contract holders of Special Annuity should convert to Series B, because it would give them a larger return.

(44) That Series B Contract is the best contract Fidelity ever submitted to the public, and it gives the public a larger return than did any previous contract.

(45) That a Series B Contract gives a higher return than United States Baby Bonds, Postal Savings, Liberty Bonds, or any annuity bonds sold by any insurance company.

(46) That Fidelity is as strong financially, even stronger, than Metropolitan Life Insurance Company and the John Hancock Life Insurance Company.

(47) That the Association confines its investments to safe and conservative securities, so as not to jeopardize the investments of its contract holders.

(48) That Fidelity purchases securities and places them on deposit with the State of West Virginia, dollar for dollar of the amount invested by contract holders, and has an excess reserve over and above contract liability of \$100,000.

(49) That Fidelity Investment Association is restricted like any good insurance company in the type of securities it is permitted to purchase.

(50) That an investment with the Fidelity Investment Association is safer than with the trust department of a bank.

(51) That the Fidelity Investment Association invests money received from contract holders only in the United States Government Bonds.

(52) That each investor's dollar is on deposit and readily available at any time.

(53) That Fidelity is making surplus payments to contract holders and earning enough to continue to make surplus payments, as it has in the past.

(54) That by depositing \$15 every month for a period of 10½ years, the contract holder will receive \$2,500 in cash immediately at the end of the said period of time.

(55) That, as shown by financial statements of the Fidelity Investment Association, as of December 31, 1937, and June 30, 1938, the company is in a strong, sound, and secure financial position, without disclosure that the Fidelity Investment Association has wholly owned subsidiaries which are investment companies; and that it carries bonds issued by those subsidiaries in its portfolio and that the value of cost of certain securities is based in part upon interfund transactions.

(56) That one of the prohibitions placed upon Fidelity is that it cannot purchase common stock for its investment portfolio, because it is supervised by the insurance department of the State of West Virginia and operates under the same restriction as any of the insurance companies in the purchase of securities for its investment portfolio.

(57) That Fidelity is required to carry on deposit 110% of all moneys deposited with it by contract holders.

(58) That no contract holder ever lost money by investing in the Fidelity Investment Association.

(59) That there are absolutely no charges or fees in the purchase of a Fidelity Income Reserve Contract.

(60) That by investing \$7.50 monthly for 120 months in the Series D Contract, the investor will absolutely receive \$1,200 at the end of that period of time.

(61) That the Series D Contract in the past paid contract holders at least \$300 surplus participation on a face value contract of \$1,200, and that the same amount could be expected to be received with the increased financial strength of the Fidelity Investment Association.

(62) That Fidelity has been in existence for fifty years, and is a strong, safe, and secure financial institution; in fact, is as strong financially as any insurance company.

(63) That a contract holder will definitely receive six percent on all moneys deposited on the Series B Contract with Fidelity Investment Association.

(64) That the contract holder is guaranteed against loss at all times.

(65) That Fidelity operates under the insurance laws of the State of West Virginia and has to be a financial institution with an A-1 rating, in order to do business in West Virginia, which has very strict and severe insurance laws.

(66) That the Series B Contract not only has the backing of the Fidelity Investment Association, but also has the backing of the State of West Virginia, which insured said contracts.

(67) That, after making payments to the Fidelity Investment Association for one year, the contract holder will get dollar for dollar of all moneys invested at the end of that period of time.

(68) That Fidelity Investment Association is stronger than any insurance company, because it has the State of West Virginia behind it in insuring the guaranteed contract payments to contract holders dollar for dollar of the amount they pay in.

(69) That a Series B contract holder will receive not less than $3\frac{1}{2}\%$ of all moneys invested and it might go to 5% plus the accumulation of any dividends which in the past have run from 8% to 10%.

(70) That there is no cost in purchasing the Income Reserve Contract, Series B, from Fidelity until the end of the tenth year when \$60 is deducted for insurance charges.

I have read the foregoing affidavit and swear it is true and correct to the best of my knowledge and belief.

(S) JOHN T. CALLAHAN.

Subscribed and sworn to before me this 14 day of December 1938.

(S) JOHN H. GROGAN,

Notary Public, County of Wayne, State of Michigan.

My commission expires March 21, 1939.

DISTRICT COURT OF THE UNITED STATES FOR THE
EASTERN DISTRICT OF MICHIGAN

Affidavit

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF,

v.

FIDELITY INVESTMENT ASSOCIATION, DEFENDANT

STATE OF MICHIGAN,

County of Wayne, ss.:

EDWARD C. JAEGERMAN, being duly sworn, deposes and says:

I

I am one of the attorneys for the Securities and Exchange Commission. In an order issued by the Commission on May 17, 1938, John T. Callahan and I were designated as officers of the Securities and Exchange Commission to make an investigation of the Fidelity Investment Association (hereinafter referred to as defendant) and its wholly owned subsidiary, Fidel Association of New York, Incorporated. Pursuant to the order, I directed an examination of the books, records, reports, documents, and correspondence of defendant to be made by a staff of Commission accountants at defendant's home office in Wheeling, West Virginia; and at its branch office in New York, New York; and at the offices of its wholly owned subsidiaries, Paull Company, Marston Corporation, and Marietta Company in Cleveland, Ohio.

On numerous occasions I personally visited defendant's home office in Wheeling, West Virginia, and its branch office in New York City, New York, and personally read, studied, and examined financial and other reports, books, records, documents, legal opinions, contract certificates, printed and written sales literature, sales kits and portfolios, pamphlets, memoranda, committee and directors' minute books, and voluminous correspondence, all relating to defendant and its subsidiaries; its transactions, practices and courses of business; and the manner in which the securities issued by it were and are being offered and sold generally to the public by defendant and its Agency Division. On several occasions I visited Charleston, West Virginia, and personally examined books, records, documents, and correspondence relating to defendant and maintained by Mr. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia and by the Charleston National Bank of Charleston, West Virginia.

On numerous occasions in Wheeling, West Virginia; New York, New York; Charleston, West Virginia; and Cleveland, Ohio, I, as officer of the Commission, questioned, examined, and took sworn testimony from numerous witnesses who had and have knowledge of the affairs of defendant and the manner in which the securities issued by it were and are being offered and sold to the public. Witnesses examined by me include numerous officers, directors, and employees of defendant; various state officials; and divers other persons.

II

From the data herein referred to, from my investigation, from the answers of persons questioned by me, and from the sworn testimony of witnesses

examined by me and by John T. Callahan, I am now informed and believe, and on information and belief allege that:

The defendant is engaged and about to engage in acts and practices which constitute and will constitute violations of Section 17 (a) of the Securities Act of 1933.

III

As appears from its charter, defendant was incorporated in West Virginia April 26, 1911. More than a year and a half later it purchased the West Virginia Annuity Bond business of an Atlanta, Georgia corporation in financial difficulties and commenced the business of soliciting and receiving deposits and payments on contracts, certificates, and bonds calling for initial and monthly payments to defendant by purchasers thereof, and providing for lump sum settlement by defendant at a specified future date after completion of payments or, at the option of the purchaser, periodic payment by defendant of definite amounts over a period of years. Thereafter, defendant did and now does business by virtue of and under that section of the West Virginia code which is labeled "Annuity Companies" (Chapter 33, Article 9, West Virginia Code).

IV

As at June 30, 1938, defendant, through its Agency Division and through its wholly owned subsidiary, Fidel Association of New York, Incorporated, maintained and now maintains 58 district offices in:

Allentown, Pa.	Glens Falls, N. Y.	Racine, Wis.
Atlanta, Ga.	Grand Rapids, Mich.	Reading, Pa.
Aurora, Ill.	Green Bay, Wis.	Richmond, Va.
Baltimore, Md.	Harrisburg, Pa.	Roanoke, Va.
Battle Creek, Mich.	Huntington, W. Va.	Saginaw, Mich.
Bluefield, W. Va.	Indianapolis, Ind.	Sandusky, Ohio.
Bridgeport, Conn.	Kansas City, Mo.	Savanna, Ill.
Buffalo, N. Y.	Knoxville, Tenn.	Scranton, Pa.
Charleston, W. Va.	LaCrosse, Wis.	Sheboygan, Wis.
Chicago, Ill.	Louisville, Ky.	St. Louis, Mo.
Cincinnati, Ohio.	Milwaukee, Wis.	Tarentum, Pa.
Cleveland, Ohio.	Montgomery, Ala.	Toledo, Ohio.
Columbia, Mo.	Nashville, Tenn.	Uniontown, Pa.
Columbia, S. C.	New Orleans, La.	Washington, D. C.
Columbus, Ohio.	New York, N. Y.	Wheeling, W. Va.
Cumberland, Md.	Parkersburg, W. Va.	Wilkes-Barre, Pa.
Dayton, Ohio.	Peoria, Ill.	Wilmington, Del.
Detroit, Mich.	Philadelphia, Pa.	Youngstown, Ohio.
Erie, Pa.	Pittsburgh, Pa.	
Fairmont, W. Va.	Pottsville, Pa.	

for the purpose of sale of its securities to the general public in the territories adjacent to said offices; advertises in newspaper and magazines having a national circulation; and maintains a staff of approximately 2,000 sales persons, sales managers, supervisors, and division supervisors, whose remuneration was and is dependent upon commissions and overriding commissions, based upon the amount of securities sold.

Approximately 60,000 purchasers resident throughout the United States send and are continuing to send in their monthly payments regularly to defendant through the United States mails, or to district offices which, in turn forward said payments to defendant through the United States mails. Defendant confirms sale of and forwards its securities through the United States mails, and sends monthly receipts and notices of payments due to all purchasers through the United States mails.

V

The books of defendant reflect that since November 9, 1920, defendant has issued and sold to the general public about 200,000 contract certificates with a total face amount of approximately \$600,000,000. As at June 3, 1938, the books of defendant reflect that 112,542 of these certificates were outstanding with a total face amount of \$276,223,450. The series of contracts sold during this period include:

- Special Income Contracts (November 9, 1920–April 23, 1925).
- Special Annuity Contracts (April 23, 1925–February 1932).
- Income Reserve Contracts, Series A (March 1932–June 15, 1934).
- Income Reserve Contracts, Series B (June 15, 1934, to date).
- Income Reserve Contracts, Series D (July 23, 1935, to date).
- Fidel Collateral Trust Bonds, Series A, Guarantees (June 1932–December 1934).
- Fidel Collateral Trust Bonds, Series B, Guarantees (January 1935, to date).

Each series of contracts sold calls for the creation and maintenance by defendant of Special Funds for the benefit of a particular class of contract holders, and calls for purchase and deposit in trust of underlying portfolio securities delimited by the West Virginia code or statute by virtue of and under which defendant has operated and operates.

VI

The West Virginia law specifically requires defendant to deposit with the State Treasurer of West Virginia "in trust, for the benefit of its contract holders" a qualifying general deposit of \$100,000 in legally defined eligible securities before it may transact business. Thereafter, in addition to such qualifying deposit, defendant is by statute required to "maintain at all times a deposit with the State Treasurer" of legally defined eligible securities to an amount equal to the total amount which defendant may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of deposit. The descriptive words of the statute read as follows:

"The words 'bonds and securities' used in the foregoing section, shall be construed to mean bonds or obligations of the United States; or bonds of any state or any political subdivision thereof, (including bonds issued by the West Virginia bridge commission); or bonds or obligations of any foreign government, or territorial possession thereof; or bonds of any private corporation secured by first mortgage or trust deed on its property; or debentures, notes, preferred or guaranteed stocks of a corporation whose net income applicable to payment of dividends for five years next preceding the date of their being offered for deposit shall have been equal to at least four percent per annum on the par value on all its outstanding stock, or, in case its stock has no par value, then on the value at which such stock was issued; or bills and acceptances eligible for purchase by federal reserve banks; or notes or bonds secured by first mortgage or trust deed on improved real estate, to an amount not exceeding fifty percent of its appraised value, if they be accompanied by proper abstract of title and fire insurance policy or policies to adequately protect the improvements on such real estate: *Provided*, That no corporation shall deposit, under this article, more than ten percent of any preferred or guaranteed stock of any issuing corporation."

The provisions of the above statute are clear and unequivocal.

When, by the laws of any other state, defendant shall have been required to make and shall have made a deposit (similar to that required in West Virginia) in such state, equal or greater in amount, for the benefit of contract holders in such state, upon the filing of a certificate to such effect from the proper officer in such state with the Insurance Commissioner of West Virginia, defend-

ant is not required to make an additional deposit with the Treasurer of West Virginia for the benefit of its contract holders in such other state, but shall be given credit for such extraterritorial deposits.

Defendant may not invest more than 10% of its assets in the securities of any one corporation. Statutory requirements preliminary to doing business in other states in which defendant operates include general qualifying deposits in fixed amounts of cash or designated securities. Periodical subsequent deposits of designated securities, against liabilities to contract holders in such states, are obligatory. On the failure of defendant to make additional deposits with the State Treasurer of West Virginia when required, its license to do business shall be revoked. Whenever its liabilities exceed its assets, its license shall be suspended until its assets are increased to exceed its liabilities. No director or officer may receive any money or valuable thing for negotiating or recommending any loan from defendant for aiding in the sale of any stocks, bonds, or other securities to defendant and no loan or investment may be made without either the approval of a majority of a committee of at least three directors empowered to make investments or the approval of a majority of the directors at a meeting of the directors. Every officer or director knowingly consenting to a loan or investment in wilful violation of the West Virginia statute shall be personally liable for any loss sustained by such investment and such officer or director shall also be guilty of a felony. Any person violating any provision of this West Virginia statute shall be guilty of a misdemeanor.

VII

The above-mentioned contract securities issued and sold by defendant by their terms expressly incorporate the various restrictions and qualifications of the above-described West Virginia code or statute, in addition to other and more exacting obligations upon the part of the defendant Association.

Defendant's sales persons and selling literature stress the "safeguards," "advantages," and "protection" contract holders assured by the requirements of the West Virginia and other statutes, in the jurisdiction where defendant sells its securities, and represent to prospective purchasers that all the terms of said statutes are very strictly complied with by defendant. Defendant supplies its salespersons with facsimile certificates and letters from various West Virginia state officials, and these facsimiles are used in the sale of defendant's securities. Permission to use these facsimiles for selling purposes has not been granted but has been expressly objected to by said officials. Many persons have relied and rely upon these oral and written representations when purchasing the contract securities issued by defendant.

VIII

Each series of contracts issued and sold by defendant is separately described in Plaintiff's verified Bill of Complaint (paragraphs IX through XIII).

The Special Income, Special Annuity, Series A, Series B, and Series D Contracts, are in their operation and terms fundamentally alike. All bear unit face maturities which represent the aggregate of an optional ten annual installment settlement. Income and Annuity Contracts call for a \$60 initial payment to defendant and 126 monthly payments of \$10 each. Series A Contract calls for initial payment to defendant of \$100 and 132 monthly payments of \$10 each. Series B and Series D Contracts respectively call for 126 and 120 monthly payments to defendant of \$7.50 each, but prospective purchasers are pressed for a substantial down payment, equivalent to six or more monthly payments.

A very substantial portion of the payments during the early years of the contracts is deducted by defendant as its agency and underwriting fees, as follows:

Special income.....	\$126.00
Special annuity	104.00
Series A.....	110.25
Series B with insurance protection.....	129.70
Series B without insurance protection.....	84.70
Series D.....	83.18

Each series of contracts has a loan and/or cash surrender feature, and allows for the issuance of a paid up contract in lieu of additional monthly payments, after a minimum number of monthly payments have been made. Monthly payments must be made by the purchaser on each series of contracts for from 6½ to 9 years, depending upon the contract series, before the purchaser may withdraw from defendant as much money, without interest, as he had paid to defendant. Any prior cash surrender and withdrawal results in loss to the contract holder.

The monthly payments after fees and charges are deducted, are required by the terms of each series of contracts to be set aside in an active Reserve Fund for each series, to be created and maintained by defendant for all active contract holders. Depending upon the particular series of contracts, defendant is obligated to improve each of these specific Active Reserve Funds at the following Rates:

5% per annum, compounded semiannually;
 4½% per annum, compounded semiannually;
 4% per annum, compounded quarterly; and
 4% per annum, compounded annually.

Defendant is further obligated, by the express terms of each series of contracts and by the laws of West Virginia under which it operates, to invest all moneys in said Funds, less loans to contract holders, in the securities specifically defined, described and delimited by the above quoted laws of West Virginia, and to deposit said securities in trust with the Treasurer of West Virginia. Defendant's sales persons represent that defendant fully complies with this obligation. Sales to contract holders are made upon this representation.

At the completion of all required monthly payments to defendant the "maturity date" of each contract is reached. At, or shortly after this date, the purchaser may withdraw from defendant a specific amount of cash, or may select one of the several optional installment settlements. At the maturity date if the earnings, accumulations, and appreciation in each specific Active Fund have been in excess of its required improvement, a "surplus" results which, in accordance with the terms of the Special Income and Special Annuity Contracts, belongs exclusively to and is to be equitably distributed to the registered holders of said contracts in good standing, at maturity. In Series A, Series B, and Series D Contracts this "surplus" is figured periodically on the basis of the lower of cost or market value of the underlying portfolio securities and is apportioned, half to the contract holders and half to defendant. Defendant withdraws its half portion immediately, on the basis of a fluctuating market value, prior to Surplus distribution to the contract holders.

At the date fixed for surplus apportionment in each maturing Special Annuity, Series A, Series B, and Series D Contract, defendant is required to withdraw from the various special Active Reserve Funds a sum sufficient to mature or retire each of said contracts (the required accumulations therefor), which withdrawals, for each series of contracts, constitute a Maturity and Retirement Reserve Fund. These Maturity and Retirement Reserve Funds must also be

invested in securities specifically defined, described, and delimited by the above-quoted West Virginia statute, deposited in trust with the Treasurer of West Virginia, and improved at the following rates:

Special annuity, 5% per annum, compounded annually,
Series A, 4% per annum, compounded quarterly,
Series B, 4½% per annum, compounded semiannually,
Series D, 4% per annum, compounded annually.

After the initial and at least 36 monthly payments have been made on a Special Income Contract, the holder may surrender his contract and receive a Special Income Paid Up Contract, the reserve for which defendant agrees to maintain and improve at the rate of 5% semiannually to maturity and at the rate of 5% annually thereafter.

By the terms of the various contracts, defendant receives any excess earnings and accretions of the various Maturity and Retirement Reserve Funds and of the Special Income Paid Up Fund.

IX

As at December 31, 1937, and June 30, 1938, the following Funds had substantial deficits, based upon the market value of the underlying portfolio securities:

Special Income Active Reserve Fund.
Special Income Paid Up Fund.
Special Annuity Active Reserve Fund.
Special Annuity Maturity and Retirement Reserve Fund.
Series A Active Reserve Fund.
Series B Active Reserve Fund.
Series B Maturity and Retirement Reserve Fund.
Series D Active Reserve Fund.
Series D Maturity and Retirement Reserve Fund.

To date, defendant has not made up the deficits in these Reserve Funds. The source, other than market appreciation, from which the contract deficits must be made up is defendant's General or Stockholders' Fund. This is also the source upon which ultimately depends defendant's guarantee of payment on all contracts issued by it, and defendant's written unconditional guarantee of full and faithful performance by Fidel Association of New York, Incorporated, of all its obligations under the Collateral Trust Bonds, Series A and B, issued by said Fidel Association.

The \$100,000 qualifying deposit in West Virginia, and substantial qualifying deposits in other States must be from defendant's General Fund. As of December 31, 1937, and June 30, 1938, defendant's General Fund showed a capital impairment, based upon the market value of the underlying portfolio securities. Substantially all of the underlying portfolio securities of defendant's General Fund were and are pledged with the State of West Virginia for the purpose of making up deposit deficiencies of the various Contract Funds.

X

The Contract Certificates which defendant issues and the terms of the West Virginia and other statutes under which defendant operates create between defendant and the various classes of contract holders a trust relationship. This trust relationship is specific and definite. The various Special Active Funds and the Maturity and Retirement Reserve Funds which defendant is obligated to create and maintain are trust funds dedicated to a particular purpose. The moneys which defendant receives from contract holders, from the specific provisions of the contracts issued and sold by defendant, are impressed with a

trust. Defendant must create special reserves for the benefit of particular classes of contract holders and may not commingle all reserves generally for the benefit of all policy holders. Defendant is a paid trustee in that it receives agency and underwriting fees as compensation for its duties under the terms of the various contracts issued by it. Defendant's securities are in part sold upon assurances of safety and strict accountability to be derived from the above-described trust and fiduciary capacity and obligation.

In his confidential report to the president and board of directors in 1932, Fred S. Risley, Vice-President and Secretary, described this trust relationship as follows:

"The Association has, during its existence of more than twenty-one years, issued eleven different Bonds and/or Contracts, each of which by its respective terms required the creating of specific Reserves for their maturity with the exception of the 'Paid-Up Annuity Contracts' and the 'Paid-Up Income Reserve Contract.' In these instances, special accounting only is required.

"These various issues were designated as follows:

- Ten-Year Bonds, 'Blank' Series.
- Ten-Year Bonds, 'A' Series.
- Ten-Year Bonds, 'B' Series.
- 'C' Bonds.
- 'D' Bonds.
- Special Income Contracts.
- Paid-Up Income Contracts.
- Special Annuity Contracts.
- Paid-Up Annuity Contracts.
- Income Reserve Contracts.
- Paid-Up Income Reserve Contracts.

"Final settlement has been made on all of the 'Blank' Series of the Ten-Year Bonds. No further payments are being received on the 'A' and 'B' Ten-Year Bonds, the Association's liability on these two issues is a known and fixed amount and a proper reserve has been set aside to take care of the final settlement when these Bonds are presented for payment.

"The remaining issues, by their terms, except as previously noted, require separate accounting, each has its own investment portfolio and bank accounts, which with the division known as the 'General Account' representing the funds belonging to, or in which the Stockholders have an interest, requires an accounting system similar to that of a Trust Company with five trusteeships.

* * * * *

"In making an analysis of the respective 'positions' of the various reserves and the company, consideration must be given to the fact that the funds belonging to these reserves and the income therefrom must be treated as separate 'trusts' and cannot be intermingled, either between 'Trusts' or with funds belonging to the Stockholders."

Hubert F. Young, Vice-President, in charge of the Investment Department of defendant, was examined by deponent in New York, New York, on November 7 and 8, 1938 and testified as follows:

"By MR. JAEGERMAN:

"Q. Isn't there a trust relationship between Fidelity and the various persons who deposit their money under the various contracts sold by Fidelity?

"A. I would say there is."

A memorandum, dated September 3, 1935, prepared by Vice-President Hubert F. Young and submitted to Carmi A. Thompson, John Marshall, Howard Sutherland, Arthur B. Koontz and Walter Grosscup, whose offices are President, Chairman of the Board, directors and members of the Investment and Advisory Committees of defendant, reads in part as follows:

"It is obviously impossible for the Association to bolster up the Income Account at the expense of the Annuity or the Income Reserve 'A' and 'B' Accounts, for these Accounts are in effect separate trust funds held for respective

contract holders. Securities transferred to those Accounts must be done at or near current market quotations and must be securities deemed suitable investments for those Reserve Funds."

Mr. Young read this quotation into the record and was questioned as follows:

"By MR. JAEGERMAN:

"Q. So that you at any rate recognized the trust relationship and nature of this——

"A. Oh, yes.

"Q. So that you, at least, if no one else in the Association, recognized and clearly stated the trust relationship that existed as far as the Association was concerned and its contract holders?

"A. That is right.

"Q. And the various series of contract holders?

"A. That is right.

"Q. Separating the trust relationship as being distinct for each series of contracts sold?

"A. That's right.

"Q. And you still realize and understand this complex trust relationship that exists?

"A. Yes."

A memorandum reviewing Investment Committee operations during 1936, prepared by Vice-President Hubert F. Young and submitted to the Investment Committee of defendant and certain officers and directors, reads in part as follows:

"The Funds representing the reserves behind the various contracts that the Association has issued are kept separate and distinct, and are not, and cannot be, intermingled in one common Fund."

Mr. Young on the record testified that this was another expression of the trust relationship.

In discussing the purchase of a common stock, Mr. Young testified as follows:

"MR. YOUNG. Let me explain that a little better.

"MR. JAEGERMAN. Yes.

"MR. YOUNG. I have remarked a number of times to my associates in the office that I thought this one purchase would bring the Income Account up, but I always looked on the General and the Income as two ——

"By MR. CALLAHAN:

"Q. In other words, Income is insolvent?

"A. Insolvent, and in my opinion they are really one account today, although one is a trust and one is capital stock.

"Q. Does the Investment Committee hold the same opinion, too?

"A. Of course, they are familiar with that."

Arthur B. Koontz, director and member of the Investment and Advisory Committee of the defendant, was questioned as follows with respect to any trust relationship existing between defendant and its contract holders:

"By MR. JAEGERMAN:

"Q. What do you know about the relationship existing between Fidelity Investment Association on one hand and the contract holders on the other?

"A. Elaborate on your question just a little bit, please.

"Q. Contract holders pay money into Fidelity?

"A. That is true.

"Q. Fidelity extracts certain fees and charges?

"A. That is true.

"Q. How must Fidelity treat the balance of those payments?

"A. Invest it in securities for the benefit of contract holders.

"Q. Therefore, a trust relationship develops?

"A. I should say so. It is a relationship in the nature of a trust relationship whether it is an absolute trust relationship. I have always regarded it as a relationship in the nature of a trust relationship.

* * * * *

"By Mr. JAEGERMAN :

"Q. What do you think of this affair of interfund transfer of securities?

"A. It is not necessarily wrong in all cases, but I don't like it, frankly. It is like selling a bank—the trust department of a bank funds—securities from one fund to another—

"Q. Would you do it?

"A. No, not under present practice. In the old days banks did do it.

"Q. They got into trouble, too, didn't they?

"A. Yes *** Under present practice in banks they don't do that. They sell the securities to the brokers and then buy them back.

"By Mr. JACKSON :

"Q. Regular outside sale?

"A. That is right. Now the fund business might be perfectly all right but I don't like the practice.

"By Mr. JAEGERMAN :

"Q. Especially when it is a selective process to take profits?

"A. No sir.

"Q. It is not such a good idea, is it?

"A. But I don't admit it is wrong.

"Q. I am not asking you to admit anything. I think the facts will speak for themselves.

"A. Well, that is right. I am trying to be very frank."

Tom B. Foulk, Vice President and general attorney for defendant, was questioned with respect to the trust fund theory.

The following is a quotation from the legal opinions of Mr. Foulk submitted to defendant from time to time; and identified by Mr. Foulk :

1. (2/12/29—Special Income Contract.) "Money once placed in a Reserve Account is legally consecrated and may not be withdrawn."

2. (7/25/29—Special Income and Special Annuity Contracts) "nor would any Court of equitable justice deem the transfer of such trust funds to a special account a perversion of the trust imposed upon them."

3. (9/20/29—Special Income Contract.) "There was little in the realm of express, implied, constructive or other trusts from Court decisions or legal works to guide me."

4. (4/12/32—Special Income and Special Annuity Contracts.) "There seems to be one big legal point involved that overshadows any other points which could be supported by Court decisions. Our reserves for various contracts are handled in the nature of distinct trust funds or Accounts. Necessarily, each trust fund should and does stand on its own peculiar resources and contract holders may not look to any other Reserve Account than that created for the particular contracts to have the same fulfilled. I am persuaded this is legally sound, even though our institution may be imperiled thereby, bringing grief to contract holders dependent on other reserves. Is not our position similar to that of a bank and trust company with numerous trust funds which they may not commingle or purchase from one trust fund to help another, despite the

fact that failure to pay out on one Trust Account might close the institution? Of course, I appreciate that trust funds are segregated and not commingled with general funds of a bank."

Mr. Foulk read the above quotation into the record. He was questioned as follows:

"By Mr. JAEGERMAN:

"Q. Do you feel the same way about this opinion as you did then, Mr. Foulk?

"A. Do you mean that I might have been a little more moderate or the language was not well chosen, or something?

"Q. No.

"A. I think the principle is right, yes.

"Q. That is all I am asking for, the principle.

"A. Yes.

"Q. Now, Mr. Foulk, do you know anything about the interfund over-drafts?

"A. No.

"Q. Was it ever disclosed to you as general attorney that the Association was commingling actual cash coming in from various classes of contracts and was permitting one Contract Fund to overdraw from another Contract Fund, and was permitting the General Fund to overdraw from Contract Funds, such over-drafts at times amounting to approximately five million dollars?

"A. No, I never knew that to be a fact.

"Q. Would you have permitted that if you had known?

"A. I don't see how I could. I think on one occasion I was told that the Funds had an over-draft of several hundred thousand dollars, but the General Account could take care of it. I don't recall a thing such as you suggest here. No.

"Q. And if that were true, it would be a violation of this trust principle and certainly contra to this opinion of April 1932 which deals with a related subject?

"A. I will have to study the answer to that, now, because that letter deals with a direct deliberate purchase of funds at other than a fair value, and now you are asking me if temporarily money might be transferred.

"Q. Let us not say 'temporarily'; if the overdraft is permitted to exist for a period of years?

"A. No, I couldn't approve of that. I think generically you are right on the same basis as that letter.

"Q. That you could not approve such a thing?

"A. That is right.

"Q. Especially since the contracts say that the moneys paid in by contract holders after the fees and charges to a certain maximum are deducted shall be invested in approved securities and deposited in trust with West Virginia, the Treasurer of West Virginia?

"A. Well, I will accept that for all it seems to import."

XI

Within the past three years, defendant has created and now maintains three separate wholly owned subsidiary corporations: Paull Company, Marston Corporation, and Marietta Company (formerly known as Pau-Mar Corporation), all West Virginia corporations.

Paull Company and Marston Corporation took over and acquired from certain Contract Funds and from the General Fund real estate and real estate securities, most of which were and are in various stages of default, and the National Sales Agency, Inc. notes (described in detail in the Affidavit for

Accountant-Investigator Ben E. Jackson, attached to Plaintiff's Application for Order to Show Cause in this Action). In exchange therefor, the subsidiaries issued their respective collateral trust bonds in a face amount identical with the book figures at which said real estate, real estate securities, and National Sales Agency, Inc. notes were being carried on the books of the Association, which book figures greatly exceeded the market value at date of transfer, and greatly exceed present market value.

Marietta Company has taken over certain real estate originally transferred to Paull Company and Marston Corporation and, through cash advances made by defendant, has financed the acquisition and construction cost of defendant's new Home Office Building. Marietta Company has issued a small amount of its securities and is to issue further securities in exchange therefor.

XII

Upon information and belief:

From May 27, 1933, defendant, in the sale of securities issued by it, by redate and otherwise; namely, Special Income, Special Annuity, Income Reserve Series A, Income Reserve Series B, and Income Reserve Series D Contracts and Fidel Association of New York, Incorporated Collateral Trust Bonds Series A and Series B Guarantees, by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly has engaged and is now engaging in transactions, practices, and courses of business which operates, would operate, and did operate as a fraud and deceit upon the purchasers of said securities, in that defendant, as a regular practice in selling said securities, intended to and did—

(1) Fail to purchase and deposit in trust sufficient bonds and other securities, as required by the laws of the State of West Virginia (described in Mr. Jackson's Affidavit) and by the terms of the various contract securities (described in the above-mentioned Affidavit) issued by defendant;

(2) Purchase and deposit with the Treasurer of West Virginia bonds and other securities in default or which did not and do not meet the requirements of the above-described West Virginia statute;

(3) Fail to maintain at all times a sufficient deposit with the Treasurer of West Virginia and with other State officers and agencies, as required by the laws of said States and by the terms of the contract securities issued by defendant;

(4) Deposits, in States requiring deposit, securities belonging to Special Contract Funds in excess of the liability of said funds to contract holders residing in said States; using the excess to cover in part or wholly the liabilities of other Contract Funds; although representing to prospective purchasers: "Securities deposited with state departments in accordance with legal requirements of each State in which we operate";

(5) Deposit with the Treasurer of West Virginia portfolio securities purchased with moneys of specific Contract Funds, without requiring physical segregation of said securities as to said specific Contract Funds;

(6) Fail to separately segregate and apply separately cash payments received from specific classes of contract holders; and, commingling said cash payments, permit defendant's General Fund and certain Contract Funds to overdraw cash in very large amounts from other Contract Funds, said overdrafts at times totaling in excess of \$5,000,000, with and without interest allowances, and in violation of contract and statutory requirements as to investment and deposit;

(7) Through its General Fund, create, maintain, and operate a margin trading account in speculative securities, while at the same time overdrawing cash for defendant's General Fund from Specific Contract Funds;

(8) Fail to maintain at all times the required reserves against existing contract liabilities; and fail adequately to restore by contribution from the General Fund deficiencies existing at various times in specific Contract Funds;

(9) Fail to provide out of surplus and undivided profits or current earnings, reserves for depreciation and against loss on sale of securities and for contingencies;

(10) Transfer to defendant's General Fund approximately \$400,000 of "Gains on Terminated Contracts—Annuity" which, from 1925 through 1937 had accumulated as accretions to the Special Annuity Active Fund, recognized as belonging exclusively to "persistent" annuity contractholders;

(11) By means of bookkeeping entries, effect the "sale" or transfer of securities between Contract Funds and between Contract Funds and the General Fund, usually at prices substantially in excess of the then book value of the securities transferred; increasing the so-called "cost" of the securities and the "profits" of said funds by well over \$1,000,000, as of December 31, 1937, and materially affecting the mechanics of evaluation for the purpose of surplus distribution;

(12) Create a General Fund "earned surplus" out of moneys or "profits" made available by the practices above described (failure to restore deficiencies in Contract Reserves; failure to provide reserves for contingencies; transfers of "Gains on Terminated Contracts—Annuity"; writing up of book value of securities through interfund transfers), and, out of said surplus, declare and pay dividends to both common and preferred stockholders of defendant;

(13) Through its investment committee and directors, purchase with moneys of Contract Funds and the General Fund securities in so-called "Special Situations," in which officers, directors, and members of the investment committee of defendant were interested in capacities other than in connection with their duties to defendant Association, and, in at least one instance, to the personal benefit of various officers and directors of defendant.

XIII

Upon information and belief:

From July 15, 1936, defendant, in the sale of the above-described securities issued by it, by the use of means and instruments of transportation and communication in interstate commerce, and by the use of the mails, directly and indirectly, has employed and is now employing devices, schemes, and artifices to defraud the purchasers thereof, in that defendant created and now maintains wholly owned subsidiaries; namely, Paull Company, Marston Corporation, and Marietta Company, representing to various State agencies that said subsidiaries would be liquidating companies to take over and liquidate certain real estate and real estate securities, but actually, as is more particularly described in the Affidavit Ben E. Johnson, mentioned above, defendant organized said subsidiaries and transferred certain questionable assets thereto—

(1) To conceal the indebtedness of the insolvent and dormant National Sales Agency, Inc., to the General Fund and to the various Contract Funds;

(2) To conceal from the general public the investment of moneys of the Association and of the various Contract Funds in certain real estate and real estate securities, most of which were and are in default, and which were being carried at a book value greatly in excess of the then market value;

(3) To create the semblance of depositability for and to increase the West Virginia deposit value of the above described holdings, by approximately \$1,500,000 through the substitution therefor of "collateral trust bonds" issued by said wholly owned subsidiaries;

(4) To permit the continued purchase and indirect deposit with West Virginia of defaulted and speculative real estate issues and securities ineligible for deposit according to the laws of West Virginia by having such subsidiaries purchase said defaulted and ineligible securities and issue such "collateral trust bonds" in exchange therefor;

(5) To facilitate transfer of Notes Receivable and defaulted real estate securities between Contract Funds and the General Fund at prices higher than market by substituting "collateral trust bonds" at the "book value" of said securities and transferring such bonds at "book" or "sound" values, higher than market;

(6) To obtain from the various Contract Funds moneys for the erection of a new Home Office Building by selling said Funds preferred stock and other securities issued by Marietta Company; and to enable defendant to carry said new Home Office Building on the books of defendant as "bonds" or "other securities," rather than as "real estate."

XIV

Upon information and belief:

From December 31, 1936, defendant, in the sale of the above-described securities issued by it, by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly, has obtained and is now obtaining money and property by means of untrue statements of material facts and omissions to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they are made, not misleading, in that defendant represented and caused to be represented to prospective purchasers, through the means of financial statements in pamphlet form, attached to Plaintiff's Bill of Complaint and marked Exhibits A, B, and C; through national advertising; and through its sales personnel:

(1) That certain financial statements (Exhibits A, B and C) duplicated in "credit files", national advertising and sales literature supplied to all sales persons and to active contract holders, were and are true, whereas in truth and in fact, said financial statements, as defendant well knew, are false and misleading and their use withholds and suppresses material facts, as defendant was informed by its own auditor, as per Exhibit D attached to Plaintiff's Bill of Complaint and made a part thereof;

(2) That the "assets" of defendant are in excess of sums variously represented to be from \$30,000,000 to \$37,000,000, whereas in truth and in fact, said sums, for the most part, represent a combination of "assets" segregated in and belonging to Special Contract Funds which are restricted for the exclusive benefit of specific classes of contract holders, as segregated;

(3) That "Reserves for Contract-Owners" are common funds similar to reserves required for insurance companies and generally available for the benefit of all policy-holders, whereas in truth and in fact, by virtue of the terms of the contract certificates issued by defendant, said "Reserves" are, for the most part, restricted for the exclusive benefit of specific classes of contract holders;

(4) That Exhibits A, B and C are consolidated financial statements of defendant Association, whereas in truth and in fact said Exhibits are in no way consolidated statements, but are essentially very condensed combined statements of

Contract and General Funds, with investment in wholly owned subsidiaries only partially eliminated, and, as the defendant well knew, with use of said statements concealing large cash overdrafts in various Funds and the nature of the underlying assets of three wholly owned subsidiaries;

(5) That bonds, preferred stocks and other securities are valued at "cost" or amortized value, without disclosing that said "cost" is a book value in many instances artificially inflated by a selective process of interfund transfers;

(6) That the "consolidated" investment of defendant in real estate is but \$50,000; and that the balance of defendant's investments and the investments of the various Contract Funds are in highest grade liquid bonds, whereas in truth and in fact, defendant's real estate holdings, through its wholly owned subsidiaries, are very substantially in excess of \$50,000; and in truth and in fact, as the defendant well knew, a very substantial portion of the remaining investments of defendant and of the various Contract Funds are not in high grade liquid bonds;

(7) That the Contract Funds have always earned their required contract yields and have built up substantial surpluses, whereas, in truth and in fact, certain Contract Funds have not earned and are not earning their required contract yields and have substantial deficits; and, in truth and in fact, a very substantial percentage of the assets of defendant and of the various Contract Funds are securities which have no yield, or which have limited earnings which do not approximate the required contract yields;

(8) That defendant has never missed a maturity and has never borrowed from an outside source to meet its obligations, but omitted to state that maturities were in part met by defendant's conversion of maturing and matured contracts into preferred stock and into new contracts and paid up contracts issued by defendant; by defendant's persuasion of matured contract holders to accept delayed settlements, rather than lump sum cash payment; by profits from defendant's loan margin trading account; and by defendant's practice of very large cash overdrafts or borrowings between Contract Funds, at times exceeding five million dollars.

(9) That the costs attached to contract certificates issued and sold by defendant are nominal, or that there are no costs and deductions, whereas, in truth and in fact, as defendant well knew, agency, underwriting, and other costs attached to said certificates are very substantial and are to a very large extent deducted from the early payments by contract holders, as outlined in Exhibit E, attached to Plaintiff's Bill of Complaint and made a part thereof;

(10) That insurance protection in Series B Contracts with insurance is furnished without cost to the contract holder, whereas, in truth and in fact, the contract holder pays \$45 out of his deposits for insurance protection;

(11) That the full contract face amount is paid to the purchaser shortly after completion of required deposits, whereas, in truth and fact, said amount represents the aggregate of an optional installment settlement extending more than ten years after completion of required deposits;

(12) That contract holders may withdraw their full deposits at any time after one, two, or three years, whereas, in truth and in fact, the contract holder may not withdraw a sum equivalent to the aggregate of his deposits before the 109th monthly deposit on Series B Contract with insurance, or the 89th month without insurance, or before the 95th month on a Series D Contract;

(13) That defendant pays from 4% to 5% on any moneys deposited with it by contract holders, and that defendant's contracts are better than savings bank deposits and United States Baby Bonds, whereas, in truth and in fact, as defendant well knew, depending upon whether the immediate lump sum or the ten

annual income coupon settlement is chosen by contract holders, average yield after completion of all required payments on Series B Contracts ranges from 1.55% to 3.38%, and on Series D Contracts ranges from 2.05% to 2.86%; and as explained in sub-paragraph (12), there is no yield to the contract holder before the 109th, 89th, or 95th monthly deposit.

XV

The acts and practices above set forth have been engaged in by the defendant over a long period of time and have continued, or their effects have continued, subsequent to the time that deponent and John T. Callahan, of the Securities and Exchange Commission, initiated this investigation.

Such acts and practices as these and others outlined in the Affidavits filed herein, which have been pursued by defendant over a long period of time perpetrate a substantial and continual fraud on the public. The way in which defendant can be stopped from continuing the same practices in the future is for this honourable Court to grant the relief demanded by the Plaintiff in this action.

XVI

WHEREFORE, the deponent makes application in behalf of the Plaintiff, Securities and Exchange Commission, and asks for an order requiring the defendant to show cause; on the 19th day of December, 1938, at 10 o'clock in the forenoon or as soon thereafter as counsel can be heard in the District Court of the United States for the Eastern District of Michigan, Southern Division, at Room 707 of the Federal Building, Fort and Shelby Streets, in the City of Detroit, County of Wayne, State of Michigan, why a temporary injunction should not issue out of this Court enjoining and restraining defendant, its officers, directors, agents, representatives, salesmen, employees, successors, and assigns, and all persons acting under its direction or in its behalf, and each of them, during the pendency of this action and until final hearing from, in the sale of securities issued by defendant, namely Special Income, Special Annuity, Series A, Series B, and Series D Contracts, and Fidel A and B Guarantees or any other securities, by the use of means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly;

A. Engaging in transactions, practices, or courses of business which would operate or do operate as a fraud or deceit upon purchasers, particularly—

1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements, or

2. Failing to segregate and maintain at all times sufficient statutory deposits against appropriate liabilities, or

3. Failing to create and maintain separate Contract Reserve Funds; or commingling cash receipts; or permitting cash overdrafts between various Contract Funds, or

4. Failing to maintain required reserves or to restore deficiencies in specific Contract Reserves, or

5. Engaging in margin trading accounts, or

6. Transferring to defendant's General Fund gains belonging to Contract Funds, or

7. Increasing "cost" of securities and "profits" of various funds by a selective process of interfund transfer of securities, or

8. Creating questionable "earned surpluses," and paying dividends therefrom, or

9. Purchasing securities in so-called "special situations," to the personal benefit of officers, directors, and employees of defendant, or any other acts or

practices that would and do operate as a fraud or deceit upon purchasers similar to those specifically set forth above or of a similar purport or object.

B. Employing a device, scheme, or artifice to defraud, particularly in the creation and maintenance of wholly owned subsidiaries to conceal the nature of certain indebtednesses and investments, to artificially increase deposit values and avoid statutory deposit requirements, and to facilitate interfund transfers of notes and securities at prices other than market, or employing any other device, scheme, or artifice to defraud purchasers, similar to those specifically set forth above, or of a similar purport or object.

C. Obtaining money or property by means of untrue statements of material facts or omissions to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they are made, not misleading, concerning

1. The truth of financial or other statements which withhold or suppress material facts;

2. The extent and availability of "assets" of defendant and of the various Contract Funds;

3. The extent and availability of Contract Reserves;

4. The "cost" of certain portfolio securities, the book value of which is enhanced by interfund or other transfers;

5. The rating, nature, and liquidity of the investments of defendant and of the various Contract Funds;

6. The yield, earnings, and financial condition of defendant and of the various Contract Funds;

7. The means used by defendant to meet contract maturities, and the extent of borrowings by defendant;

8. The costs attached to securities issued and sold by defendant, and their incidence;

9. The amounts payable to or withdrawable by contract holders;

10. The yield paid by defendant to contract holders, or any other untrue statements of material facts or other omissions to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they are made, not misleading, similar to those specifically set forth above or of similar purport or object. For such other and further relief as is just.

XVII

There has been no previous application made in this action for an order to show cause or for the relief herein demanded.

I have read the foregoing affidavit and swear that it is true and correct to the best of my knowledge and belief.

EDWARD C. JAEGERMAN,
Attorney, Securities and Exchange Commission.

Sworn and subscribed before me this 14th day of December, 1938.

JOHN H. GROGAN,
Notary Public.

DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN
DISTRICT OF MICHIGAN

Affidavit

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

FIDELITY INVESTMENT ASSOCIATION, DEFENDANT

STATE OF MICHIGAN,

County of Wayne, ss.

BEN E. JACKSON, being duly sworn, deposes and says:

I

I am an accountant-investigator for the Securities and Exchange Commission. In the course of my official duties, on or about August 20, 1938, I was directed to proceed to the Wheeling, West Virginia, Home Office of Fidelity Investment Association, a West Virginia corporation (hereinafter referred to as defendant) and to its branch offices in New York City and elsewhere, to supervise and conduct an examination of the books, records, reports, documents, and correspondence of defendant; of its wholly owned subsidiaries, Fidel Association of New York, Incorporated, a New York corporation; Paull Company, Marston Corporation, and Marietta Company, all West Virginia corporations; and of a West Virginia corporation known as National Sales Agency, Inc.

I supervised and conducted an examination of financial and other reports, books, records, documents, legal opinions, contract certificates, printed and written sales literature, pamphlets, memoranda, committee and directors' minute books, and voluminous correspondence, all relating to defendant, and its subsidiary and affiliated companies; its transactions, practices, and courses of business; and the manner in which the securities issued by it were and are being offered and sold generally to the public by defendant and its Agency Division.

On numerous occasions in Wheeling, West Virginia, Charleston, West Virginia, and Cleveland, Ohio, I attended hearings before John T. Callahan and Edward C. Jaegerman, as officers of the Securities and Exchange Commission at which hearings sworn testimony was taken from numerous witnesses who had and have knowledge of the affairs of defendant and the manner in which the securities issued by it were and are being offered and sold to the public. Witnesses examined include numerous officers, directors, and employees of defendant, various State officials, and divers other persons.

From the above-described investigation and examination, and from the sworn testimony of witnesses, I am now informed and believe, and on information and belief allege that:

II

Fidelity Investment Association was incorporated under the laws of West Virginia on April 26, 1911, as "Fidelity Investment Loan Association", a loan company. On November 22, 1912, it purchased the West Virginia annuity bond business of the Guaranty Trust and Banking Company of Atlanta, Georgia. On December 7, 1912, defendant's name was changed to "Fidelity Investment Association."

Defendant's original authorized capitalization was \$100,000, consisting of 100 shares of common stock of \$100 par value. Present authorized capitalization is

\$13,000,000, consisting of 30,000 shares of common stock of \$100 par value and 100,000 shares of 5% cumulative preferred stock of \$100 par value. As at February 10, 1926, total issued and outstanding capital stock of defendant was \$150,000, consisting of 1,500 shares of \$100 par value common stock. From February 10, 1926, to date, defendant has increased its capital represented by common shares by declaring and paying stock dividends in common stock totalling approximately 6,024 shares, of a total par value of \$602,400, and by selling to the public 600 additional shares of a total par value of \$60,000, making total issued and outstanding common stock 8,123 shares, of a total par value of \$812,300.

On August 10, 1931, an issue of 5% cumulative preferred stock of a par value of \$100, with voting rights in the event of default of annual dividends, was authorized, in part to be offered to registered holders of outstanding Special Income Certificates and Special Annuity Certificates of defendant, in exchange for the surrender and cancellation of said contracts at a stated valuation. From November 1931 to November 1932, 5,051 preferred shares having a total par value of \$505,100 were thus sold or exchanged. On December 23, 1936, a 50% stock dividend on all outstanding common shares, payable in preferred stock, was paid by the issuance of 4,059 preferred shares, for a total par value of \$405,900. As of December 31, 1937, the total issued and outstanding capital stock, common and preferred, of defendant was \$1,723,300. Of this, common and preferred shares for a total par value of \$1,022,326.66 were issued as stock dividends. For the balance of the shares, \$752,517.01 (including \$51,543.67 of premiums on common stock) was paid in.

III

From August 12, 1913, to September 6, 1934, sales to the general public of securities issued by defendant were made through National Sales Agency, Inc., a West Virginia corporation owned and controlled by one Fred M. King. National Sales Agency, Inc., habitually obtained large monthly advances from defendant in excess of actual earned commissions and against pledge of stock control.

From September 6, 1934, to date, all sales to the general public of securities issued by defendant have been and are made by defendant's Agency Division, formed to take over certain functions, assets, and liabilities of National Sales Agency, Inc. As at September 6, 1934, the indebtedness of National Sales Agency, Inc., to defendant amounted to \$1,056,716.27 and was evidenced by National Sales Agency, Inc., notes. Defendant's capital and surplus were insufficient to allow for these notes to be written off as worthless, without materially affecting the solvency of defendant. To maintain the semblance of value for said notes, defendant's Agency Division "operates exclusively for the benefit of National Sales Agency, Inc.," and pays principal and interest on said National Sales Agency, Inc., notes, by virtue of payments received from defendant in amounts sufficient for said purpose. National Sales Agency, Inc., has been dormant since September 6, 1934, and for a number of years has been and now is insolvent, chief "assets" having been unsecured loans to Fred M. King, subsequently discharged in bankruptcy, and to sales personnel. These assets, to the extent of approximately \$650,000, were written off, subsequent to September 6, 1934, as worthless. The remaining assets have little or no liquidating value.

IV

The books and records of defendant reflect that from November 9, 1920, defendant has issued and sold to the general public about 200,000 contract

certificates for a total face amount of approximately \$600,000,000, as follows (to June 30, 1938) :

Number of contracts	Contract series	Total face value	Period of sales
38,504	Special income.....	\$113,330,000	November 1920-April 1925.
21,843	Special annuity.....	268,218,000	April 1925-February 1932.
24,759	Income reserve, series A.....	60,465,000	March 1932-June 1934.
47,811	Income reserve, series B.....	102,126,250	June 1934-June 1938.
10,457	Income reserve, series D.....	20,690,400	July 1935-June 1938.

As at June 30, 1938, 112,542 of these certificates were outstanding with a total face value of \$276,223,450.

Each series of contracts sold calls for the creation and maintenance of Reserves and Special Funds for the benefit of a particular class of contract holders. Special Funds include an Active Fund for each series, and a Maturity and Retirement Reserve Fund for Special Annuity, Income Reserve, Series A, Income Reserve, Series B, and Income Reserve, Series D, contracts. The Special Income Contracts call for the creation and maintenance of a Special Income Paid Up Fund. For each Fund the contracts call for the purchase and deposit in trust with the Treasurer of West Virginia underlying portfolio securities as delimited by the West Virginia code or statute which regulates the conduct of the business of defendant.

The books of defendant do not reflect the creation and maintenance of Maturity and Retirement Reserve Funds for Special Annuity, Income Reserve Series A, Income Reserve Series B, or Income Reserve Series D Contracts, or of a Special Income Paid Up Fund, until September 30, 1937. Prior thereto, these Reserves and their assets were commingled with assets in defendant's General Fund, but with certain securities earmarked as belonging to Income Reserve Series B and Income Reserve Series D Maturity and Retirement Reserve Funds.

V

The reports of financial condition prepared for and submitted to defendant by its regularly employed independent auditors, and the market and other valuations prepared and used by defendant's personnel as at December 31, 1937, and at June 30, 1938, reflect substantial deficits in various Contract Funds, as follows :

Contract reserve funds	Deficit, Dec. 31, 1937	Deficit, June 30, 1938
Special income, active.....	\$758,756.66	\$783,180.88
Special income, maturity and retirement.....	77,048.37	57,448.37
Special annuity, active.....	1,001,069.57	1,000,044.24
Special annuity, maturity and retirement.....	717,424.77	667,123.74
Income reserve, series A, active.....	247,326.02	276,605.92
Income reserve, series A, maturity and retirement.....	• 888.48	• 1,334.84
Income reserve, series B, active.....	465,068.10	494,116.36
Income reserve, series B, maturity and retirement.....	126,791.87	150,080.82
Income reserve, series D, active.....	24,396.58	32,298.60
Income reserve, series D, maturity and retirement.....	36,196.93	37,488.03
Total.....	3,453,190.39	3,497,052.12

• Surplus.

In the above computations, Paull Company and Marston Corporation collateral trust bonds of over \$4,000,000 par value, held in the Special Income and Special Annuity Reserve Funds, were evaluated at a "Cragin" value, which, as testified to by Mr. Raymond T. Cragin, its author, was substantially in excess of market value of the underlying portfolio securities.

In addition to the above-described Contract Reserve Fund deficits, the reports and evaluations of defendant reflect that the portfolio securities in defendant's General Fund had a depreciation of \$924,560.12 as at December 31, 1937, and of \$874,886.48 as at June 30, 1938. Capital and surplus of defendant at these dates, as reflected in defendant's books and reports, amounted to \$2,211,504.61 and \$2,181,185.35, respectively.

Defendant guarantees payment on all contracts issued by it and by its wholly owned subsidiary, Fidel Association of New York, Incorporated. The assets of the General or Stockholders' Fund, which are the only source giving value to defendant's guarantee, consist chiefly of common stocks and defaulted bonds, of which, as at December 31, 1937, approximately \$1,250,000 book value was and is pledged and deposited with the Treasurer of West Virginia to cover deficiencies in the required deposits of securities for the various Contract Funds. The market value (and West Virginia pledge value) of the deposited General Fund securities, as per valuations prepared and submitted by defendant, was only approximately 50% of the said "book value," as at December 31, 1937.

The securities records of the defendants show the location of said securities but the general books and published financial statements of defendant do not reflect or disclose the pledging of these securities and the fact that same are restricted and are not in the possession or control of defendant. These securities may not be withdrawn from deposit unless their equivalent in value is substituted. The deficits in the various Contract Funds, based on the market values of underlying portfolio securities, preclude any possibility of substitution from that source.

Defendant's general books do not disclose any reserve for contingencies or against loss from securities depreciation in the Contract Funds and in the General Fund. The books and records of defendant showed total surplus as at December 31, 1937, and June 30, 1938, to be approximately \$457,000 and \$485,000, respectively. Although on the basis of valuations prepared and submitted by defendant and its independent auditors, the total deficits in the Contract Funds at December 31, 1937, and June 30, 1938, were approximately \$4,000,000, and although according to reports of defendant's independent auditor, Ralph V. Wilson (C. P. A., Ohio) total depreciation on the market and "Cragin" valuation of securities in all Contract Funds and the General Fund were approximately \$5,900,000 at December 31, 1937, and \$6,000,000 as at June 30, 1938, defendant regularly declared and paid both common and preferred dividends to its stockholders during 1937 and 1938.

VI

The Fidel Association of New York, Incorporated, was incorporated in the State of New York on or about October 19, 1931, and all of its issued and outstanding capital stock of \$100,000 is owned by defendant. This wholly owned subsidiary of defendant was created for the purpose of selling securities to the general public in New York, Connecticut, and New Jersey. From June 1932, through December 1934, Fidel Association of New York, Incorporated, issued and sold 4,507 Collateral Trust Bonds, Series A, for a total face amount of \$12,682,000. From January 1935, to date, this subsidiary has issued and sold, and is now issuing and selling Collateral Trust Bonds, Series B. As at June 30, 1938, 4,518 Col-

lateral Trust Bonds, Series B, were issued and sold for a total face amount of \$10,487,500. Said Collateral Trust Bonds contain an unconditional guarantee by the defendant for the full and faithful performance by its subsidiary. Defendant's General Fund is thus charged with the performance of said guarantee.

VII

On or about July 15, 1936, defendant organized and had incorporated under the laws of the State of West Virginia the Paull Company and the Marston Corporation, each with an issued and outstanding capital stock of \$5,000, held by defendant. On or about August 19, 1936, defendant organized and had incorporated under the laws of the State of West Virginia the Pau-Mar Corporation (name later changed to Marietta Company) with issued and outstanding common stock of \$5,000, divided equally between Paull Company and Marston Corporation. \$130,000 face value of 5% preferred stock was issued by Marietta Company, purchased by defendant and subsequently resold to the Annuity Maturity and Retirement Reserve Fund at par value.

The books of defendant and of its subsidiaries reflect that during 1936 Paull Company and Marston Corporation acquired at book values aggregating \$4,385,003.42 from certain Contract Funds and the General Fund real estate and real estate securities, most of which were and are in various stages of default; and, at their face value, the National Sales Agency, Inc., notes aggregating \$890,235.91.

The National Sales Agency, Inc., notes and the real estate and real estate securities transferred to the subsidiaries were and are for the most part ineligible for deposit with the Treasurer of West Virginia, or, when eligible, are acceptable at values greatly below book values. The Contract Funds and the General Fund received, in exchange for the above-mentioned notes and real estate securities, 3% Collateral Trust Bonds, due 1951, of the Paull Company and Marston Corporation, for a total par value of \$4,413,000. Defendant deposited these bonds with the Treasurer of West Virginia at their par value. This deposit value was subsequently reduced, but has at all times been and now is substantially in excess of the market value of the underlying collateral. By depositing these Collateral Trust Bonds, defendant was enabled to do indirectly that which it could not do directly, and was enabled to increase its deposit value with the State of West Virginia by approximately \$1,500,000.

The books and records of defendant reflect the following transactions between the Contract Funds and the General Fund and between the Contract Funds and Paull Company and Marston Corporation in 1936, 1937, and 1938:

December 31, 1936.—Sale of \$1,000,000 par value Marston Corporation 3% Collateral Trust Bonds, from the Special Income Active Reserve Fund to the Special Annuity Active Reserve Fund at 67, for a loss to the Special Income Fund of \$330,000.

December 31, 1936.—Sale of \$468,000 par value Paull Company 3% Collateral Trust Bonds from defendant's General Fund to the Special Annuity Active Reserve Fund at 82½, for a loss to the General Fund of \$81,900.

July 30, 1937.—Purchase by Special Annuity Active Reserve Fund from Marston Corporation of \$8,000 par value Marston Corporation 3% Collateral Trust Bonds at par, for \$8,000.

October 8, 1937.—Purchase by Special Annuity-Maturity and Retirement Reserve Fund from Paull Company of \$25,000 par value Paull Company 3% Collateral Trust Bonds at par for \$25,000 (transferred to the Annuity Maturity and Retirement Fund on October 30, 1937, at par).

January 15, 1938.—Sale of \$62,000 par value Marston Corporation 3% Collateral Trust Bonds from the Special Annuity Active Reserve Fund to Marston Corporation for redemption and cancellation at 67¼. (Gain to Marston Corporation was the difference between 67¼ and 100 on \$62,000 bonds, or \$20,305.)

March 31, 1938.—Sale of \$50,000 par value Paull Company 3% Collateral Trust Bonds from the Special Annuity Active Reserve Fund to the Paull Company for redemption and cancellation at 82½. (Since average cost to Annuity Fund was 94,796, this sale resulted in loss to Special Annuity Active Reserve Fund of \$6,148.30; gain to Paull Company was the difference between 82½ and 100, or a total of \$8,750).

June 23, 1938.—Purchase by Special Annuity Active Reserve Fund from Paull Company of \$11,000 par value Paull Company 3% Collateral Trust Bonds, at par, for \$11,000.

Profit from the retirement of bonds by Marston Corporation and Paull Company Collateral Trust Bonds was credited to the Profit and Loss Account and thus used to reduce operating deficits of these two subsidiaries.

Marietta Company took over certain real estate originally transferred to Paull Company and Marston Corporation and gave its notes to the latter companies therefor. At December 31, 1937, these notes totalled \$435,391.98, and, at June 30, 1938, totalled \$446,391.98. Through cash advances from defendant, the Marietta Company financed the acquisition and construction of defendant's new Home Office Building. Marietta Company was to issue its 4½% bonds in addition to its preferred stock to cover said advances, but has not as yet done so. As at June 30, 1938, approximately \$300,000 value of bonds or other securities was and is due from Marietta Company.

Defendant issued and published, and sent through the United States mails to its contract holders, a financial statement in pamphlet form as at June 30, 1938, attached to plaintiff's bill of complaint as Exhibit "C", in which said \$300,000 is labeled as "bonds", without explanation. The financing of the Home Office Building in this manner permits defendant to show a fixed asset, namely, real estate, on its balance sheet as bonds, implying liquidity and concealing the true facts from present and prospective purchasers of defendant's securities who have a right to rely on said financial statement as being true and correct.

VIII

In order to qualify to do business in the State of West Virginia and other states, defendant has to make certain qualifying General Fund or Capital Account. In addition, various states require defendant to deposit sufficient securities *at market value* to cover cash liabilities to contract holders resident in said states. Every state other than West Virginia values securities deposited with it at market for the protection of contract holders resident in said states. Defendant has obtained from the auditor of West Virginia a "valuation per valuation plan" for the purpose of determining the sufficiency of its securities deposits with the Treasurer of West Virginia. This evaluation plan in effect credits defendant with the par value of substantially all bonds deposited by it (except for defaulted bonds, which are valued at market). This enables defendant to purchase and deposit speculative bonds selling in certain instances for less than 50% of their par value, and to obtain from the auditor of West Virginia for deposit purposes a valuation of par for said bonds.

The defendant does not require physical segregation as to specific Contract Funds of portfolio securities deposited by it with the Treasurer of West Virginia. This enables defendant to make substitutions and to effect interfund

sales or transfers of securities, without notification to or the approval of the West Virginia authorities. Defendant has at various times failed to purchase and deposit in trust sufficient bonds and other securities as required and delimited by the laws of West Virginia and the terms of the various contract securities issued by defendant. Defendant has purchased and deposited with the Treasurer of West Virginia bonds and other securities in default or which did not and do not meet the requirements of the West Virginia statute. Defendant has failed to maintain at all times a sufficient deposit with the Treasurer of West Virginia and with other state officers and agencies as required by the laws of said states and by the terms of the contract securities issued by said defendant.

Defendant has deposited, in states requiring deposit, securities belonging to Special Contract Funds in excess of the liability of said Funds to contract holders residing in said states; using the excess to cover in part or wholly the liabilities of other Contract Funds; although representing to prospective purchasers: "Securities Deposited With State Departments In Accordance With Legal Requirements In Each State In Which We Operate."

IX

For many years defendant has failed to segregate and apply separately cash payments received from specific classes of contract holders. Continuing this practice, defendant now does commingle in one common bank account all monies paid in by persons holding Special Income, Special Annuity, and Income Reserve Series A Contracts, with the monies of defendant's General Fund. Defendant permits overdrafts between the various Contract Funds and between the General Fund and the various Contract Funds. Before 1933, no interest allowances were made to the lending Funds. These overdrafts are in violation of contract and statutory requirements as to investment and deposit. Due to these overdrafts, at times the General Fund was indebted to various Contract Funds in amounts in excess of \$2,000,000, while at the same time said General Fund was operating a speculative Margin Trading Account in securities with New York City brokers. From defendant's books and records and from defendant's daily report of bank balances, submitted daily to sixteen of its principal officers and directors, it appears that cash has been and is now being disbursed for the defendant's General Fund and for various Contract Funds without regard to whether each of said Funds has a cash balance to its credit.

Interfund overdrafts reached a peak total of approximately \$5,000,000 as of September 30, 1936. At this time defendant's General Fund was indebted to various Contract Funds in the amount of approximately \$2,000,000, and the Special Income Active Fund was indebted to other Contract Funds in the amount of approximately \$3,000,000. These overdrafts were covered, so far as the bank was concerned, by defendant's drawing against cash balances to the credit of the Special Annuity Active Fund and the Income Reserve Series A Active Fund. As at December 31, 1937, interfund overdrafts between all funds, Contract and General, totaled \$2,351,513.99, and as at June 30, 1938, \$2,071,751.14.

Various officers and directors stated in their sworn testimony that the above overdrafts resulted because certain Contract Funds had insufficient cash on hand to meet contract maturity, cash surrender, and loan demands. According to the testimony, overdrafts were essential because the "borrowing" Contract Funds could not liquidate sufficient underlying portfolio securities to meet cash demands, without suffering such heavy losses as to impair the solvency of the Contract Funds and the capital of defendant.

As of December 31, 1937, the Special Income Active Fund was short \$756,744.87 in its cash account and the Special Annuity Maturity and Retirement Reserve Fund was short \$1,585,734.83. The underlying portfolio securities of these funds are carried by defendant at a "book" value very substantially in excess of the then market value. If underlying portfolio securities were sold from these funds to cover cash overdrafts, defendant would have to contribute cash equal to the loss, or difference between book and market value. Defendant's capital surplus and earned surplus at this time on its books amounted to \$488,204.61. As of December 31, 1937, the difference between book and market value of the underlying portfolio securities of the Special Income Active Fund and the Special Annuity Maturity and Retirement Reserve Fund aggregated respectively \$758,756.66 and \$717,424.77. The only source from which defendant could make up realized losses in the various Contract Funds is from Defendant's General Fund. However, for the past several years and to date, defendant has pledged practically all of the marketable securities of its General Fund with the various states to cover deposits deficiencies in the various Contract Funds. If the General Fund should withdraw such deposited securities from the various states for the purpose of sale, other equivalent securities necessarily would have to be deposited. As of December 31, 1937, practically no such additional securities acceptable for deposit were available from any source.

As of June 30, 1938, and as of October 31, 1938, the position of defendant and the various Contract Funds in these respects remained practically unchanged. As of November 23, 1938, defendant's "independent auditors," Wilson and Meredith (C. P. A.'s Ohio), in commenting in their audit report for the month of October, 1938, pointed out the existence of the above-mentioned facts and questioned the practice of defendant's commingling the cash of various Contract Funds; of defendant's permitting the practice of interfund and General Fund overdrafts; and of defendant's commingling of securities for the purpose of deposit with various States. It was suggested that defendant take steps to correct the conditions resulting from said practices.

The above situation explains why defendant has failed to maintain at all times the required reserves against existing contract liabilities, on a market basis, and why defendant has failed adequately to restore by contribution from the General Fund deficiencies existing at various times in specific Contract Funds.

X

The July 25, 1933, minutes of the Investment Committee contain the following authorizations: "On motion of Mr. Koontz, seconded by Mr. Marshall, Comptroller Young was authorized to negotiate a loan with Jackson and Curtis not exceeding \$1,000,000, the funds to be used in the purchase of selected securities." As a result of this authorization, defendant through its General Fund, created and maintained a margin account in speculative securities while at the same time overdrawing cash for defendant's General Fund from specific Contract Funds. This margin trading account remained active until June 1937.

XI

During 1937 and 1938, on the basis of so-called legal opinions, defendant withdrew approximately \$400,000 out of the Special Annuity Active Fund as "profits" due to defendant's General Fund. Approximately \$300,000 of this sum was credited to defendant's Earned Surplus Account for the year, and the remainder was credited to current earnings. This "profit" was and is carried on the books of defendant as "Gains on Terminated Contracts—Annuity." These gains

represent the difference between the cash surrender value and the required reserve on all Annuity Contracts cash surrendered or liquidated prior to maturity during the period from 1925 to date. Until 1937, these gains were retained as part of the "book reserves" of the Special Annuity Active Fund, being considered accretions or profits thereto, belonging to "persistent" active Annuity Contract holders in good standing.

Although the transfer of these gains to the General Fund was contrary to the established practice with respect to the Annuity Active Fund and was contrary to the way similar gains were and are treated under other series of Contracts issued by defendant, and although defendant stood and stands in a trust relationship to the Annuity contract holders as a class, defendant not only transferred these gains but charged the Annuity Active Fund interest at the rate of $4\frac{1}{2}\%$ compounded semiannually, for the use of each individual item of gain which accrued from 1925. Interest charged amounted to approximately \$50,000. The General Fund has never paid interest to the Annuity Active Fund for large amounts of cash overdrawn from said Annuity Active Fund by said General Fund during the years prior to 1933.

The cost of computing said gains and interest thereon, amounting to approximately \$7,200, was paid out partly in the following manner: \$1,500 to J. B. Shepler for legal fees and \$4,500 to Wilson and Cross for accounting fees. These costs were concealed and defendant's legal and auditing expenses understated by charging said expenses to "Surplus of Assets Over Required Reserves—Annuity" account in the Special Annuity Active Reserve Fund and transferring to defendant's General Fund the net gains. In the year 1937, the above described gains contributed \$361,095.91 to defendant's General Fund Earned Surplus or Profit and Loss Account. As at December 31, 1937, said surplus amounted to but \$431,660.94. For the six months ending June 30, 1938, an additional \$12,208.24 was transferred as "gains" during that period. Defendant's earned surplus as at June 30, 1938, was only \$401,341.68. During the year 1937, defendant paid a total of \$85,952 in cash dividends on common and preferred stock. Of this amount, \$47,050 was paid subsequent to the transfer of said "gains." During the six months ending June 30, 1938, defendant paid \$30,815 in cash dividends on common and preferred stock.

XII

For many years, defendant has engaged in the practice of effecting, by means of bookkeeping entries, the "sale" or transfer of portfolio securities between Contract Funds and between Contract Funds and the General Fund, at prices which purport to be "market prices" and which are usually substantially in excess of the then book value of the securities transferred. These interfund transfers result in—

(1) Increasing the "book value" (or the so-called "cost") of the underlying portfolio securities of the various Contract Funds and defendant's General Fund;

(2) Increasing the "profits" or "book reserves" of the various Contract Funds and the "Earned Surplus" of defendant's General Fund;

(3) Providing part of the "earnings" with which defendant "improves" the various Contract Reserve Funds (by the above-described increase in "profits");

(4) Enabling defendant to pay dividends to its stockholders (out of the above-described increase in "Earned Surplus" of defendant's General Fund);

(5) Effecting the mechanics of evaluation for the purpose of surplus distribution, by marking up the "cost" of securities of a selective basis;

(6) Enabling defendant to carry on its various pamphlet balance sheets, by a selective process, portfolio securities at a new "cost" far in excess of former "book value" (inflation of over \$1,000,000 in securities "values," as at December 31, 1937).

XIII

The defendant has, through its investment committee and directors, purchased with moneys of Contract Funds and the General Fund securities in so-called "Special Situations," in which officers, directors, and members of the investment committee of defendant were and are interested in capacities other than in connection with their duties to defendant Association, and, in at least one instance, to the personal benefit of various officers and directors of defendant.

XIV

From December 31, 1936, to date, defendant has represented and caused to be represented to prospective purchasers of the securities issued by defendant, through the means of financial statements in pamphlet form attached to plaintiff's bill of complaint and marked Exhibits A, B, and C; through national advertising; and through its sales personnel:

(1) That said financial statements, duplicated in "credit files," national advertising, and sales literature supplied to all sales persons and to active contract holders, were and are true, whereas in truth and in fact, said financial statements, as defendant well knew, are false and misleading and their use withholds and suppresses material facts, as defendant was informed by its own auditor, as per Exhibit D attached to plaintiff's bill of complaint;

(2) That the "assets" of defendant are in excess of sums variously represented to be from \$30,000,000 to \$37,000,000, whereas in truth and in fact, said sums, for the most part, represent a combination of "assets" segregated in and belonging to Special Contract Funds which are restricted for the exclusive benefit of specific classes of contract holders as segregated;

(3) That "Reserves for Contract-Owners" are common funds similar to reserves required for insurance companies and generally available for the benefit of all policyholders, whereas in truth and in fact, by virtue of the terms of the contract certificates issued by defendant, said "Reserves" are, for the most part, restricted for the exclusive benefit of specific classes of contract holders;

(4) That Exhibits A, B, and C are consolidated financial statements of defendant Association, whereas in truth and in fact said Exhibits are in no way consolidated statements, but are essentially very condensed combined statements of Contract and General Funds, with investment in wholly owned subsidiaries only partially eliminated, and, as the defendant well knew, with use of said statements concealing large cash overdrafts in various Funds and the nature of the underlying assets of three wholly owned subsidiaries;

(5) That bonds, preferred stocks, and other securities are valued at "cost" or amortized value, without disclosing that said "cost" is a book value in many instances artificially inflated by a selective process of interfund transfers;

(6) That the "consolidated" investment of defendant in real estate is but \$50,000; and that the balance of defendant's investments and the investments of the various Contract Funds are in highest grade liquid bonds, whereas in truth and in fact, defendant's real estate holdings, through its wholly owned subsidiaries, are very substantially in excess of \$50,000; and in truth and in fact, as the defendant well knew, a very substantial portion of the remaining investments of defendant and of the various Contract Funds are not in high-grade liquid bonds.

XV

I have read the foregoing affidavit and swear that it is true and correct to the best of my knowledge and belief.

(S.) BEN E. JACKSON,
BEN. E. JACKSON,
Accountant-Investigator.

Subscribed and sworn to before me this 14th day of December 1938.

JOHN H. GROGAN,
Notary Public, Wayne Co., Mich.

My commission expires March 21, 1939.

The order to show cause was as follows:

DISTRICT COURT OF THE UNITED STATES FOR THE
EASTERN DISTRICT OF MICHIGAN

Civil Action, File No. 281. Order to Show Cause

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

FIDELITY INVESTMENT ASSOCIATION, A CORPORATION, DEFENDANT

Upon the verified Civil Complaint filed herein the 14th day of December, 1938,
and the annexed affidavits of the following:

Edward C. Jaegerman, sworn to the 14th day of December, 1938.
Ben E. Jackson, sworn to the 14th day of December, 1938.
John T. Callahan, sworn to the 14th day of December, 1938.
Peter T. Byrne, sworn to the 12th day of December, 1938.
Edward D. Ranck, sworn to the 5th day of December, 1938.
Clarence F. Harvey, sworn to the 5th day of December, 1938.
Hermann Zanger, sworn to the 5th day of December, 1938.
Floss L. Schutter, sworn to the 5th day of December, 1938.
Edward B. Sinclair, sworn to the 5th day of December, 1938.
Mary Beer, sworn to the 16th day of November, 1938.
George Welbon, sworn to the 16th day of November, 1938.
Stewart C. Squire, sworn to the 15th day of November, 1938.
Oscar A. Martz, sworn to the 15th day of November, 1938.
Abraham R. Lincoln, sworn to the 15th day of November, 1938.
Alfred Hettel, sworn to the 15th day of November, 1938.
William George, sworn to the 15th day of November, 1938.
Arthur R. Schlenkert, sworn to the 15th day of November, 1938.
Clifford C. Huebner, sworn to the 15th day of November, 1938.
George C. Arthur, sworn to the 5th day of December, 1938.
Myles F. Havlicek, sworn to the 6th day of December, 1938.
James G. Harasek, sworn to the 6th day of December, 1938.
Frank J. Schneller, sworn to the 5th day of December, 1938.
Gerald Wartell, sworn to the 5th day of December, 1938.
Samuel N. Salmon, sworn to the 29th day of November, 1938.
Sophia Terry, sworn to the 29th day of November, 1938.
Mary ValGallas, sworn to the 29th day of November, 1938.
James C. Watson, sworn to the 29th day of November, 1938.
Edith E. Lund, sworn to the 29th day of November, 1938.
Ethel Ferguson, sworn to the 29th day of November, 1938.
Clara E. Sottmann, sworn to the 30th day of November, 1938.
William M. Sullivan, sworn to the 29th day of November, 1938.
William H. Benson, sworn to the 30th day of November, 1938.
Max Rosenstiel, sworn to the 29th day of November, 1938.
S. Louis Schwartz, sworn to the 30th day of November, 1938.

Boleslaus S. Pierzynski, sworn to the 30th day of November, 1938.

Fred and Mary Berkowitz, sworn to the 14th day of November, 1938.

John T. Libens, sworn to the 15th day of November, 1938.

John A. Vicic, sworn to the 14th day of November, 1938.

Edgar E. Wehrung, sworn to the 14th day of November, 1938.

Leonard M. Dworken, sworn to the 12th day of November, 1938.

Carl G. Klaiss, sworn to the 14th day of November, 1938.

Fred G. Stephens, sworn to the 14th day of November, 1938.

Emil G. Kohler, sworn to the 14th day of November, 1938.

Helen Berndt, sworn to the 14th day of November, 1938.

Stella Ermekeil, sworn to the 12th day of November, 1938.

Charles A. Fleischner, sworn to the 30th day of November, 1938.

Arthur J. Olson, sworn to the 14th day of November, 1938.

and it appearing that if a temporary injunction is not granted, the defendants will continue the acts and practices complained of in the Complaint, and sufficient reason appearing therefor,

Now, ON MOTION of Chester T. Lane, John T. Callahan, and Edward C. Jaegerman, attorneys for the Plaintiff, Securities and Exchange Commission, it is

ORDERED, that the defendant, FIDELITY INVESTMENT ASSOCIATION, be and appear before this Court, at a stated term to be held in and for the United States District Court for the Eastern District of Michigan, Southern Division, at Room — of the Federal Building, Fort and Shelby Streets, in the City of Detroit, County of Wayne, State of Michigan, on the 19th day of December 1938, at 10 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard, then and there to show cause, if any they have, why the defendant, its officers, directors, agents, representatives, salesmen, employees, successors and assigns, and all persons acting under its direction or in its behalf, should not be enjoined and restrained, pending the hearing and determination of this action, from, in the sale of securities issued by defendant, namely Special Income, Special Annuity, Series A, Series B, and Series D Contracts, and Fidel A and B Guarantees, or any other securities, by the use of means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

A. Engaging in transactions, practices, or courses of business which would operate or do operate as a fraud or deceit upon purchasers, particularly—

1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements, or

2. Failing to segregate and maintain at all times sufficient statutory deposits against appropriate liabilities, or

3. Failing to create and maintain separate contract reserve funds, or commingling cash receipts, or permitting cash over-drafts between various contract funds, or

4. Failing to maintain required reserves, or to restore deficiencies in specific contract reserves, or

5. Engaging in margin trading accounts, or

6. Transferring to defendant's General Fund gains belonging to Contract Funds, or

7. Increasing "cost" of securities and "profits" of various funds by a selective process of interfund transfer of securities, or

8. Creating questionable "earned surpluses," and paying dividends therefrom, or

9. Purchasing securities in so-called "special situations", to the personal benefit of officers, directors, and employees of defendant, or any other acts or prac-

tices that would and do operate as a fraud or deceit upon purchasers similar to those specifically set forth above or of a similar purport or object.

B. Employing a device, scheme, or artifice to defraud, particularly in the creation and maintenance of wholly owned subsidiaries to conceal the nature of certain indebtedness and investments, to artificially increase deposit values and avoid statutory deposit requirements, and to facilitate interfund transfers of notes and securities at prices other than market, or employing any other device, scheme, or artifice to defraud purchasers, similar to those specifically set forth above, or of a similar purport or object.

C. Obtaining money or property by means of untrue statements of material facts or omissions to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they are made, not misleading, concerning—

1. The truth of financial or other statements which withhold or suppress material facts;

2. The extent and availability of "assets" of defendant and of the various Contract Funds;

3. The extent and availability of contract reserves;

4. The "cost" of certain portfolio securities, the book value of which is enhanced by interfund or other transfers;

5. The rating, nature, and liquidity of the investments of defendant and of the various Contract Funds;

6. The yield, earnings, and financial condition of defendant and of the various Contract Funds;

7. The means used by defendant to meet contract maturities, and the extent of borrowings by defendant;

8. The costs attached to securities issued and sold by defendant, and their incidence;

9. The amounts payable to or withdrawable by contract holders;

10. The yield paid by defendant to contract holders, or any other untrue statements of material facts or other omissions to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they are made, not misleading, similar to those specifically set forth above or of similar purport or object.

For such other and further relief as is just, and it is further

ORDERED that sufficient cause appearing therefor, let service of a copy of this order, and the affidavits upon which it is granted, upon the defendant or its attorneys before the 14th day of December, be deemed sufficient.

EDWARD J. MOINET,

United States District Judge.

Dated, Detroit, Michigan, December 14, 1938.

The answer filed by the defendant on December 22, 1938, was as follows:

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN
DISTRICT OF MICHIGAN, SOUTHERN DIVISION

Civil Action. File No. 281

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

FIDELITY INVESTMENT ASSOCIATION, A CORPORATION, DEFENDANT

ANSWER OF DEFENDANT

The answer of Fidelity Investment Association to the bill of complaint in the above entitled cause.

PARAGRAPH I. Defendant denies it is engaged in acts and practices which constitute and will constitute violations of Section 17 (a) of the Securities Act of 1933, 15 U. S. C. 77 (q) or any other section of said act.

PARAGRAPH II. Defendant admits jurisdiction is conferred on the District Court of the United States for the Eastern District of Michigan by Section 22 (a) of the Securities Act of 1933.

PARAGRAPH III. Defendant admits the allegations of this paragraph.

PARAGRAPH IV. Defendant denies it has resorted to interfund and intersubsidiary transactions in violation of the terms of the contract certificates issued by defendant or in violation of the West Virginia or other State Statutes under which defendant operates for purposes of concealment or fraud, as charged in the second full paragraph of Paragraph IV, or otherwise. Defendant also denies that it has or is engaged in transactions, practices and courses of business which operate, would operate, or did operate, or were intended to operate as a fraud and deceit upon purchasers of its contracts and denies that it has employed devices, schemes, and artifices to defraud or has obtained money and property by means of untrue statements of material facts or omissions to state material facts. Subject to the above denials defendant admits other allegations of Paragraph IV, but denies that the contracts it has sold or is now selling are securities within the meaning and intent of the Securities Act of 1933.

PARAGRAPH V. Defendant admits the allegations of this paragraph.

PARAGRAPH VI. Defendant admits the allegations of this paragraph.

PARAGRAPH VII. The National Sales Agency, Inc., is a corporation the capital stock of which is not and never has been owned by defendant. At the insistence of the Auditor of the State of West Virginia a voting trust agreement was made under date of January 31, 1933, for National Sales Agency, Inc., under which agreement nominees of defendant, as voting trustees, were permitted to vote the stock of National Sales Agency, Inc. Subsequently, in September 1934, at the insistence of said Auditor, an arrangement was made whereby defendant took over the sales organization of National Sales Agency without cost to defendant. At that time National Sales Agency had a sales organization composed of trained and experienced personnel and with established branch offices of great but

unestimable value to defendant. In order to give recognition to the value of this sales organization and to the fact that National Sales Agency had spent large sums of money creating and training such organization and promoting the sales of annuity contracts, which expenditure would inure to defendant's benefit, and in view of the indebtedness of National Sales Agency to defendant, a complete and separate set of books was opened designated "Agency Division," in which were reflected transactions relating to sales of contracts of the type previously carried on and entered in the books of National Sales Agency. The net operating profits arising therefrom were credited at the end of each year to National Sales Agency, which recorded the transactions on its records, but no part of such profits was paid to the National Sales Agency, all of such profits being credited on the debt of National Sales agency to defendant, and through the operation of this arrangement the indebtedness of National Sales Agency has, since September 6, 1934, been reduced from the original amount of approximately \$1,056,000 to approximately \$770,000, but defendant denies that this arrangement was entered into for the purpose of maintaining a semblance of value for the indebtedness of National Sales Agency to defendant and avers that the partial payment of said debt has been and future payment thereof will be, accomplished thereby without cost or loss to contract holders. Subject to the foregoing, the allegations of this paragraph are admitted.

PARAGRAPH VIII. Defendant admits the allegations of this paragraph.

PARAGRAPH IX. Defendant admits the sale of Special Income Contracts during the period of time and in the amounts alleged in this paragraph, but defendant does not agree with the construction placed upon such contracts by the plaintiff and files herewith as Exhibit A specimen copy of such contract and asks that it be read as part of this answer.

PARAGRAPH X. Defendant admits the sale of Special Annuity Contracts during the period of time and in the amounts alleged in this paragraph, but defendant does not agree with the construction placed upon such contracts by the plaintiff and files herewith as Exhibit B specimen copy of such contract and asks that it be read as part of this answer.

PARAGRAPH XI. Defendant admits the sale of Income Reserve Contracts, Series A, during the period of time and in the amounts alleged in this paragraph, but defendant does not agree with the construction placed upon such contracts by the plaintiff and files herewith as Exhibit C specimen copy of such contract and asks that it be read as part of this answer.

PARAGRAPH XII. Defendant admits the sale of Income Reserve Contracts, Series B, during the period of time and in the amounts alleged in this paragraph, but defendant does not agree with the construction placed upon such contracts by the plaintiff and files herewith as Exhibit D specimen copy of such contract and asks that it be read as part of this answer.

PARAGRAPH XIII. Defendant admits the sale of Income Reserve Contracts, Series D, during the period of time and in the amounts alleged in this paragraph, but defendant does not agree with the construction placed upon such contracts by the plaintiff and files herewith as Exhibit E specimen copy of such contract and asks that it be read as part of its answer.

PARAGRAPH XIV. Defendant admits that it guarantees payment on all contracts and has created and maintained a general fund for this purpose, but denies that such general fund shows capital impairment based upon value arrived at in accordance with the formula or plan for valuation of securities adopted, promulgated and used by the State of West Virginia.

PARAGRAPHS IX, X, XI, XII, XIII, XIV continued. The several reserve funds therein referred to did not have deficits on December 31, 1937, or June 30, 1938,

and do not now have deficits if the underlying portfolio securities are taken at book value or if they are taken at values arrived at in accordance with the formula or plan for valuation of such securities, adopted, promulgated and used by the State of West Virginia, the general fund was ample to cover any deficits that might have existed in other funds and defendant says that the apparent deficiencies in these several funds as of December 31st, 1937, and June 30th, 1938, based upon market value alone does not truthfully reflect the conditions of the funds as is demonstrated by the fact that on December 31, 1936, at market values all of such funds with the exception of the special income contract fund had surpluses. Defendant further avers that market price is not a fair or proper measure of the value for defendant's underlying portfolio securities; that said measure of valuation wholly ignores intrinsic values and inherent soundness and places emphasis upon day to day market fluctuations, whereas the soundness of banks and financial institutions depends in the last analysis upon the soundness of the country's business and industrial enterprises and should not be measured by the precarious yardstick of current market quotations which often reflect speculative and not true appraisals of intrinsic worth.

During the past ten years, defendant has paid out to contract holders the sum of \$30,246,214.15 in cash. As hereinafter shown in its answer to Paragraph XVI, due to the world-wide depression which prevailed after 1930, certain of defendant's underlying portfolio securities were adversely affected and the firm of Cragin and Morris of Cleveland, Ohio, who are outstanding real estate agents of national repute and had often been employed by the insurance department of the State of Ohio, were engaged by defendant to appraise certain of its portfolio securities and to give specialized supervision to the handling of such securities and the functioning of defendant's subsidiary corporations. Cragin and Morris appraised a portion, approximately ten per centum, of defendant's portfolio securities at approximately \$3,200,000 and on the basis of such appraisal value and the market value for all other of defendant's portfolio securities as of December 31st, 1936, all of defendant's funds, with one minor exception, had surpluses and the aggregate net surplus of all funds over reserve requirements was \$1,597,066.78 and over cash surrender liability was \$3,135,534.64, which demonstrates the utter futility of attempting to value portfolio securities of financial institutions of defendant's type by the precarious yardstick of current and often speculative market quotations.

As to income reserve contracts, Series B, mentioned in Paragraph XII and income reserve contracts, Series D, mentioned in Paragraph XV, defendant says that it has at all times properly set up and maintained the required reserve fund and made proper segregation.

PARAGRAPH XV. Defendant admits the allegations of Paragraph XV, but denies that its guarantee therein referred to or the contracts mentioned in Paragraphs IX, X, XI, XII, and XIII are securities within the definition of and subject to the Securities Act of 1933.

PARAGRAPH XVI. With reference to the subsidiary corporations referred to in this paragraph, defendant says that in common with life insurance companies and other financial institutions throughout the United States, certain of its portfolio securities were adversely affected by the depression which prevailed after 1930 particularly mortgage loan securities, and in line with the practice followed by many such institutions, defendant caused the three subsidiary corporations to be organized for the purpose of obtaining specialized handling and supervision of certain securities and of real estate, which defendant had to take over for some of its mortgage loans. The firm of Cragin and Morris, of Cleveland, Ohio, outstanding real estate agents of national repute, hereinbefore

referred to, were employed, and, with the consent and approval of the Auditor of the State of West Virginia and the Insurance Commissioner of the State of Ohio, the three subsidiary corporations were organized. Defendant avers that grave losses to itself and contract holders, which might otherwise have occurred, were avoided by and through its subsidiaries and that complete and accurate records of the operations of the subsidiaries have been kept. The functions and operations of defendant's subsidiaries have been comparable to those of subsidiaries organized by and functioning for insurance companies, banks, trust companies and other financial institutions during the depression.

PARAGRAPH XVII. Defendant denies that any of its acts, practices, transactions and courses of business were intended to or did operate as a fraud and deceit upon the purchasers of its contracts or other persons.

Defendant denies the allegations of subparagraph designated (1) of Paragraph XVII, and avers that it has on deposit in West Virginia sufficient securities as required and delimited by the laws of the State of West Virginia.

As to subparagraph designated (2) of Paragraph XVII, defendant denies that it purchased defaulted bonds for the purpose of depositing same with the Treasurer of the State of West Virginia, or that it at any time deposited with the Treasurer of said State any securities other than those acceptable to and approved by the Auditor and ex-officio Insurance Commissioner of the State of West Virginia as meeting the requirements of the laws of West Virginia.

Defendant denies in whole the allegations of subparagraph designated (3) of Paragraph XVII.

As to subparagraph designated (4) of Paragraph XVII, defendant says that in making deposits of securities in states requiring such deposits it has relied upon and complied with the instructions and requirements of the several state officials with whom the laws required deposits to be made, and upon the construction placed by such state officials upon the laws and requirements of their respective states and believes its statements to prospective purchasers, quoted in said paragraph, was and is true.

As to subparagraph (5) of Paragraph XVII, defendant says the Treasurer of the State of West Virginia has never required defendant to physically segregate securities deposited with him, but in delivering securities to said Treasurer defendant has informed him to which of the several contract funds securities belonged, and defendant has kept on its books in minute detail a record of the securities belonging to each specific contract fund.

As to subparagraph (6) of Paragraph XVII, defendant has not deposited and commingled cash payments made by contract holders as to all contracts issued by defendant, but a number of years ago defendant did deposit some cash payments in one account in bank for several of its contract issues, and did permit the creation of interfund indebtedness. Since the year 1933 defendant has charged interest on daily balances and has reduced existing interfund indebtedness as fast as circumstances would permit, and as of October 31, 1938, had so far corrected the situation that but two of the funds had any indebtedness; that such reduction has been accomplished by the sale of securities when and as market conditions justify, and defendant believes will be still further reduced within a short time, and within a reasonable time all interfund indebtedness will be eliminated, and defendant avers it did voluntarily stop creation of interfund indebtedness, except where it is absolutely necessary because of past transactions, before plaintiff began its investigation.

As to subparagraph (7) of Paragraph XVII, defendant says it has not maintained a trading account since July 1937 but did prior to that time maintain, from time to time, a trading account with general fund resources to take

advantage of lower market prices on its portfolio securities existing as the result of the great depression after defendant had sold some of such securities at higher prices, but at no time did defendant owe to said account an amount it could not have met from current bank balances at any hour. Such account resulted in a profit of more than \$200,000.00 to defendant.

Defendant denies the allegations of subparagraph (8) of Paragraph XVII.

As to subparagraph (9) of Paragraph XVII, defendant avers that it is not required by contract or by law to provide reserves therein described.

As to the allegations of subparagraph (10) of Paragraph XVII defendant admits that it made the transfer therein described and says such transfer was made upon advice of auditors of defendant, concurred in by reputable attorneys, to the effect that the fund transferred belonged to defendant and did not belong to contract holders.

As to the allegations of subparagraph (11) of Paragraph XVII, defendant says that on the 16th day of July, 1938, it voluntarily ceased effecting sales of securities between contract funds and between contract funds and the general fund although no objection to this practice was made by the State of Michigan or other states to whom detailed reports were made annually, and further says that such sales made prior to that date were made at market price without regard to whether market price was higher or lower than book value with only two exceptions. In one transaction the sale was effected inadvertently at a price in excess of market price and in the other transaction the sale was effected of defaulted bonds of a corporation which was in process of reorganization at the price named in the re-organization plan which was about to and did become effective shortly thereafter and which at the time of sale was slightly in excess of the then market price, but defendant avers that interfund sales had no more effect upon contract funds than if defendant had gone into the open market and bought or sold securities as the case might be.

As to subparagraph (12) of Paragraph XVII, defendant admits that it has declared and paid dividends to both common and preferred stockholders out of earned surplus, but denies that such surplus was created through improper manipulation or through failure to restore deficiencies in contract funds, improper failure to provide reserves for contingency, improper gains on terminated contracts, or the writing up of book value securities through interfund transfers.

As to subparagraph (13) of Paragraph XVII, defendant says that since 1929 the statute of the State of West Virginia has expressly recognized the right of any officer, director, or stockholder or corporations operating under Article 9 of Chapter 33 to borrow not to exceed ten per centum of the total capital and surplus of such corporations, and defendant has purchased some securities of corporations in which officers, directors, and members of defendant's investment committee were interested as stockholders, directors, or officers, but denies that such purchases were intended to or did commit any fraud, and upon information and belief denies that in any instance did such purchase result in personal benefit to any officer or director or member of its investment committee, and avers that all such purchases were made in the regular course of business and were such as any bank or other financial institution would have made.

PARAGRAPH XVIII. Defendant avers that the subsidiaries, Paull Company, Marston Corporation and Marietta Company, were organized for the purpose and under the circumstances described in its answer to Paragraph XVI, and denies that such subsidiaries were organized in order to conceal as charged in

subparagraphs (1) and (2) of Paragraph XVIII, or to create a semblance of depositability for securities of such subsidiaries as alleged in subparagraph (3) of Paragraph XVIII, or to permit the continued purchase and indirect deposit of defaulted and speculative real estate issues as charged in subparagraph (4), or to facilitate transfer of notes receivable and defaulted real estate securities between contract funds and the general fund as charged in subparagraph (5), or to obtain from the various contract funds money for the erection of a new home office building as charged in subparagraph (6), and avers that said subsidiaries were primarily organized and were used by defendant for the purpose of preventing loss to defendant and its contract holders as the result of defendant being required to take over certain real estate on which it had made loans which were in default and for the purpose of working out in an orderly manner the liquidation of some of the securities owned by defendant and so as to obtain specialized supervision of the handling of such real estate and the liquidation of such securities, and such subsidiaries have been used to perform functions comparable to those subsidiaries organized and used by banks and other financial institutions throughout the country during the depression.

PARAGRAPH XIX. Defendant denies that it has obtained money or property by means of untrue statements of material facts or omissions to state material facts as alleged in this Paragraph.

As to the allegations of subparagraph (1) of Paragraph XIX and certain financial statements, copies of which are filed with the bill as Exhibits A, B, and C, defendant says that its books have, since the beginning of its business, been audited each year by firms of independent auditors and accountants of national repute, and the form of financial statements shown on Exhibits A, B and C was adopted many years ago by one of such auditing firms, and the statements represented by Exhibits A, B and C and as well also similar statements published by defendant in previous years were not believed by defendant to be false or misleading either in the statements made or in omissions to state facts, but were and are believed by defendant to be condensed statements which truthfully represent the financial status of all the funds under defendant's control and supervision. Defendant admits that the letter, copy of which is filed as Exhibit D, was written as alleged in this subparagraph, but avers that after said letter was received by defendant the matters therein mentioned were discussed with Cross, the writer of said letter, and changes in defendant's financial statement were made and said statement as so changed was thereupon approved by Cross and said statement as so changed and approved was circulated by defendant.

As to subparagraph (2) of Paragraph XIX, defendant avers that there was no purpose or intent to create any false impression that defendant had assets belonging to it or in its possession and control exceeding by \$30,000,000 to \$37,000,000 the assets of special contract funds, and defendant did not by the use of Exhibits A, B and C intend or purpose to represent or to have contract holders or other persons believe anything other than that the total amount of assets of the several funds under the possession and control of defendant were as stated in such exhibits, and believes the character of the business defendant did was so well known that no one would misunderstand the statement, and defendant avers that it has never been informed or heard that any contract holder or other person so misunderstood the financial statements.

As to subparagraph (3) of said Paragraph XIX, defendant avers that it was not its purpose or intent to have contract owners or other persons believe that

the item "Reserves For Contract Owners" was or is common funds similar to reserves required for insurance companies and generally available for the benefit of all contract owners and says it has never heard of any contract owner or other persons who has so construed that item of the statement.

As to subparagraph (4) of Paragraph XIX, defendant denies that it thereby intended to falsely or fraudulently represent that Exhibits A, B and C were or are consolidated financial statements of defendant and its subsidiaries and omitted from the statement of June 30, 1938, all reference to a consolidated statement similar to the reference which appeared on the statements on December 31, 1936, and December 31, 1937, and showed on the face of statements for December 31, 1937, and June 30, 1938, that there had been included in the assets of defendant certain securities of subsidiary companies, which statement defendant believed would plainly indicate to reasonable persons that such statements did not purport to be consolidated statements of defendant and its subsidiaries, and denies that said statements were prepared so as to conceal large cash overdrafts in various funds or to conceal the nature of underlying assets of three wholly owned subsidiaries, and avers that it would have been impracticable to have issued a statement for general circulation which would have contained all of such information in detail, and avers that said statements were prepared for the purpose of and did truthfully give a condensed general picture of the assets and liabilities under the control and supervision of defendant, and each and every fact relative to defendant and its subsidiaries could have been ascertained by any person upon examination of defendant's books and records.

As to subparagraph (5) of Paragraph XIX, defendant denies that bonds, preferred stock and other securities bear a book value artificially inflated by a selective process of interfund transfers, and avers that all interfund transfers of securities made by defendant have been at market value with two exceptions as heretofore explained under paragraph XVII.

As to subparagraph (6) of Paragraph XIX, defendant avers that as hereinbefore shown it organized with the consent and approval of the Auditor of the State of West Virginia and the Insurance Commissioner of the State of Ohio certain subsidiary corporations for the purpose, among other things, of owning and managing to the best advantage certain real estate and liquidating certain securities, and defendant denies that Exhibits A, B and C falsely or fraudulently represent that defendant's investment in real estate is but \$50,000, and denies that said statements fraudulently represent that the balance of defendant's investments and investments of the various contract funds are high grade liquid bonds. Defendant avers that in truth and in fact the major portion of its investments are in United States Government, Municipal, Railroad, Public Utility and Industrial bonds.

As to subparagraphs (7), (8), (9), (10), (11), (12), and (13) of Paragraph XIX, defendant avers that it has never authorized or knowingly permitted any of its agents or representatives to make any of the statements referred to in said paragraph, and that if any such statements have been made by agents or representatives of defendant to prospective contract purchasers or other persons they have been made without defendant's authority and without its knowledge, and defendant avers that it has not and does not have any intention to accomplish sales of its contracts by statements or representations of the character described in the above numbered paragraphs, with this exception, defendant has truthfully represented that it has met all its obligations at maturity without borrowing from outside sources.

WHEREFORE, the defendant demands that the Court dismiss the plaintiff's bill, and discharge defendant from all liability in the premises and award to the defendant its costs.

(S.) O'HARA, MONTGOMERY & ANDERSON,
Attorney for Defendant.

Address: 1553 Penobscot Bldg., Detroit, Mich.

IN THE DISTRICT OF COLUMBIA,

City of Washington, To wit:

I, F. S. Risley, make solemn oath and say I am vice-president of Fidelity Investment Association, a corporation, the above named defendant; so much of the foregoing answer as concerns my own acts and deeds is true to the best of my own knowledge, and so much thereof as concerns the acts or deeds of any other person or persons I believe to be true.

(S.) F. S. RISLEY.

Subscribed and sworn to before me this 20th day of December, 1938.

[NOTARIAL SEAL]

(S.) CARVEL J. MACK,
Notary Public for District of Columbia.

The final judgment entered December 22, 1938, reads as follows:
DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN
DISTRICT OF MICHIGAN, SOUTHERN DIVISION

Civil Action. File No. 281

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

FIDELITY INVESTMENT ASSOCIATION, A CORPORATION, DEFENDANT

FINAL JUDGMENT

And now, this cause coming on to be heard this 22d day of December, 1938; and Chester T. Lane, Esq., General Counsel, and Edward C. Jaegerman, Esq., personally appearing for the Plaintiff, Securities and Exchange Commission; and Chester P. O'Hara, Esq., personally appearing for the Defendant, Fidelity Investment Association, a West Virginia corporation; and after giving due consideration to Plaintiff's verified Complaint, filed in this Court on the 14th day of December, 1938, alleging acts and practices which constitute violations of Section 17 (a) of the Securities Act of 1933, 15 U. S. C., 77q (a); and after giving due consideration to the affidavits filed in this Court by the Plaintiff on the 14th day of December, 1938, in support of Plaintiff's application, filed on the same date, for an Order to Show Cause why the Defendant should not be temporarily enjoined from the acts and practices described in Plaintiff's Complaint; and upon further consideration of Defendant's verified Answer, filed in this Court on the 21st day of December, 1938, in which Answer Defendant admits the jurisdiction of this Court, for the purposes of this action, but without admitting the allegations of the complaint, and denying past derelictions; and the Defendant, by its counsel, acting pursuant to a resolution of its Executive Committee, having consented in open court to the entry of a final judgment herein,

NOW, THEREFORE, IT IS ORDERED, ADJUDGED, AND DECREED That the Defendant, Fidelity Investment Association, its officers, directors, agents, successors, representatives, employees, and assigns be and they hereby are perpetually enjoined and restrained from, in the sale of Special Income, Special Annuity, Income Reserve Series A, Income Reserve Series B, or Income Reserve Series D. Contracts, or Guarantees of Fidel Association of New York, Incorporated, Collateral Trust Bonds Series A and Series B, or any other security, by the use of any means or instruments of transportation or communication in interstate commerce, or by the use of the mails, directly or indirectly—

A. 1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements, or

2. Failing to segregate and maintain at all times sufficient statutory deposits against appropriate liabilities, or

3. Failing to create and maintain separate contract reserve funds, or permitting cash over-drafts between various contract funds, or

4. Failing to maintain required reserves, or

5. Transferring to Defendant's general fund gains belonging to contract funds, or

6. Transferring or selling securities from one contract fund, to another contract fund, or between contract funds and the general fund; or

7. Paying dividends except from earned surplus; or

8. Purchasing securities to the personal benefit of anyone connected directly or indirectly with the Defendant, or

9. Engaging in any other similar transaction, practice or course of business in any manner would operate or does operate as a fraud or deceit.

B. Creating or maining subsidiaries to conceal the nature or amount of indebtedness or investments, or employing any other device, scheme or artifice to defraud.

C. Obtaining money or property by means of untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, concerning—

1. The truth of financial or other statements which withhold or suppress material facts, or

2. The extent or availability of reserves or assets of Defendant or of the various contract funds, or

3. The cost of portfolio securities, the book value of which has been or is enhanced or depressed, or

4. The rating, nature or liquidity of the investments of Defendant or of the various contract funds, or

5. The yield, earnings or financial condition of Defendant or of the various contract funds, or

6. The means used by Defendant to meet contract demands or maturities, or

7. The costs attached to contract certificates issued and sold by Defendant, or their incidence, or

8. The amounts payable to or withdrawable by contract holders, or

9. The yield paid by Defendant to contract holders; or to any other statements of material facts or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, similar to those specifically set forth above or of similar purport or object.

EDWARD J. MOINET,

United States District Judge.

Dated December 22, 1938.

APPENDIX Y

STATEMENT AND EXHIBITS BY INVESTORS SYNDICATE

The officials of Investors Syndicate have expressed a difference of opinion with the views of the Commission's staff as to certain phases of that corporation's operations—in particular with respect to the application of the so-called "initial payment receipts" to income. In order that the corporation's position be fully set forth, a statement by the corporation to the Commission expounding the corporation's views is contained in this appendix.¹

CERTIFICATE FUNDS AND RESERVES

Considerable confusion is caused from time to time by reason of lack of understanding of the Company's plan of operations and its actual workings thereunder. A full comprehension of the plan in action indicates conclusively that the reserves set up by the Company are adequate, the Company is sound and stable regardless of new sales and that its investment income is more than sufficient to meet its obligations to its certificate holders.

OPERATIONS

CASH RECEIVED

Cash is received from contract holders. This cash is handled as follows: A portion is credited to "Initial Payments Receipts" to pay selling commissions and other New Business expense; a portion is credited to "Collection Revenue" to equalize the interest differential and the expense differential between annual and less than annual installments; the remainder is available for investment and is credited to "Contingent Liability Reserve," where it is held until it passes into one or more other reserve accounts at anniversary dates.

FUNDS AVAILABLE FOR INVESTMENT

Contract funds available for investment are carried in the following accounts:

- (1) *Cash Surrender Values*, representing the Company's contractual liability to its contract holders. (To this, of course, must be added "Advance Payments" to determine the total contractual liability);
- (2) *Advance Payments*, representing payments by contract holders in excess of the current year's requirements;
- (3) *Contingent Liability Reserve*, representing interim payments awaiting the attainment of new anniversary dates;
- (4) *Contract and Certificate Reserve*, representing an additional reserve set up by the company to mature the contracts.

INTEREST ACCRETIONS OF CONTRACT FUNDS

"Advance Payments" bear interest at rates expressed in the contracts. All other contract funds are accumulated in accordance with reserve schedules

¹ Derived from supplementary information supplied the Commission for Investors Syndicate.

prepared by our own company actuary and approved by our consulting actuaries. Reserve Schedules are built up as follows:

(1) Total Contract Funds (i e., Cash Surrender Values, Contingent Liability Reserves, and Contract Reserves).

(2) *Plus* subsequent net payments.

(3) *Plus* interest at a gross rate.

(4) *Equals* maturity value at maturity.

GROSS INTEREST RATES

The Gross Interest Rates used in building the reserve schedules are the rates of accumulation necessary to mature those contracts on which payments are made on time through to maturity.

We estimate that the average Gross Rate of accumulation on all outstanding Installment Contract Reserves during the current year and ensuing three years will be as follows:

Year:	Rate (percent)
1939_____	6.78
1940_____	6.59
1941_____	6.34
1942_____	6.15

In other words these are the rates that would need to be earned upon the net funds if we were to assume an ideal situation where every contract holder made his payments without any delay, default or surrender.

NET INTEREST RATES

Net Interest Rates on certificate funds are the rates of accumulation necessary to meet *actual reserve costs*, after reducing the Gross Interest Rates by the effect of the following factors:

(1) *Advance Payments*, which bear interest at a rate which is always less than the Gross Rates.

(2) *Other Contract Funds*, such as Coupon and Single Payment, Paid-up Contracts, and Optional Settlements, all of which bear interest at rates considerably below the Gross Rates used in the reserve schedules.

(3) *Terminations before Maturity*, which reduce the Gross Rates by the amount of the reserve.

(4) *Delayed Payments*, which extend the due dates of the following payments and the final maturity date.

These factors are merely a recognition of the realities, and are factors that have a bearing not only upon interest costs but upon all other phases of operations—commissions paid—investment policy—bookkeeping and accounting organization, etc. The surrender charge is partially the price paid for liquidity. The delayed payment provision is the most economical method of solving the question of handling delinquent accounts without greatly increasing operating expenses. These factors are integral elements in the entire structure of the plan offered.

EFFECT OF REDUCTION FACTORS

The four reducing factors described in the foregoing paragraph will operate to reduce the average Gross Rate as shown below:

(1) *Advance Payments and Other Contract Funds* (Non-Installment) will equal approximately 16½% of all contract funds. The average rate thereon

will be 3.75% in 1939; 3.60% in 1940; 3.50% in 1941; 3.40% in 1942. This will cause a reduction from the Gross Rates, in the amounts shown below:

Year:	Reduction from gross rate (percent)
1939	0.50
194050
194147
194246

(2) *Termination before Maturity and Delayed Payments.* Based upon studies and tests which we have made of the effect of these two factors, we estimate the following reductions from the Gross Rates:

Year	Reductions from gross rates		Total
	Terminations	Delayed payments	
	Percent	Percent	Percent
1939.....	0.51	1.15	1.66
1940.....	.49	1.12	1.61
1941.....	.48	1.08	1.56
1942.....	.46	1.05	1.51

The total effect of the three reduction factors, as shown in the two schedules above, will be to reduce the Gross Rate to a Net Rate, as follows:

Year	Gross rate	Total of the 3 reduction factors	Net rate
			Percent
1939.....	6.78	2.16	4.62
1940.....	6.59	2.11	4.48
1941.....	6.34	2.03	4.31
1942.....	6.15	1.97	4.18

ABILITY TO EARN NET RATES

The company's Operating Statement or "Profit and Loss" statement is often misinterpreted. This may be due, to some extent, to the arrangement or grouping of the accounts. The attached Operating Statement, covering the years 1936, 1937, 1938, and the first quarter of 1939, has been prepared for the purpose of more clearly illustrating our actual operations and the results thereof. The arrangement is intended to show: (1) New Business Income set off against New Business Cost; (2) Investment Income set off against the cost of accumulating Contract and Certificate funds; and (3) General Operating Income set off against General Operating Expense.

Condensing the operating results for the 3¼ years, we find:

(1) That New Business Income exceeded New Business Expense by \$846,965.03. This is largely due to heavy sales during the year 1938.

(2) That Investment Income exceeded Reserve Costs (Net Interest accretions) by \$305,879.77, in spite of the fact that voluntary increases in reserves and voluntary prepayments of high-cost contracts during 1938 charged that year's operations approximately \$573,000.00. These extraordinary charges

might well have been made against surplus gains from New Business, in which event the gain from Investment Income would have been some \$878,000.00 for the 3¼ years. This shows conclusively the coverage of reserve costs by Investment Income.

(3) That income from General Operations exceeded General Operating Expense \$894,903.96 during the 3¼ years period.

(4) That the net operating gain from all sources was \$2,169,847.57.

ADDITIONAL PROOF OF ABILITY TO EARN NET RATES

While the ability of the company to cover net certificate costs from Investment Income would seem to be quite clearly shown in the foregoing paragraph, we submit the following schedule as further proof:

Year	Average contract funds	Investment income		Net contract cost	
		Amount	Percent	Amount	Percent
1936-----	\$75,642,147	\$4,227,222	5.58	\$3,790,750	5.01
1937-----	92,465,635	4,727,518	5.11	4,402,258	4.76
1938-----	109,810,829	5,428,351	4.94	5,310,874	4.83

° This excludes approximately \$573,000 of voluntary reserve increases and voluntary prepayments of high-cost contracts, which will reduce costs in future years and which are not a proper charge against 1938 costs.

OTHER MISUNDERSTOOD ACCOUNTS

Two accounts in our Operating Statements are often confused. These are "Initial Payment Receipts" and "Collection Revenue." This confusion frequently leads to a misinterpretation of the purposes and functions of the two accounts. In the annexed Operating Statement we have placed these items in such positions as will clearly illustrate the part they play in our operations. We will now define the two accounts and attempt to further clarify their functions.

INITIAL PAYMENT RECEIPTS

"Initial Payment Receipts" come from that portion of the early payments on Installment Contracts which are necessary to be used to pay Selling Costs and other expense which is properly chargeable to New Business. From an examination of the Operating Statement, it will be noted that the charges allocated against New Business are as follows:

Kind of expense:	Percent
Commissions paid -----	100
Advertising -----	100
Collection fees -----	100
Convention expense -----	100
Other operating expense -----	75

While it is obvious that the use of an allocation of 75% of "Other Operating Expense" is an estimate used in lieu of an elaborate and expensive system of cost accounting, we believe it to be conservative and fair based on our knowledge of our activities.

Life insurance companies, in their treatment of premiums on New Business, follow a practice substantially the same as ours, and arrive at exactly the same net results. Gross Premiums on New Business (Initial Payment Receipts) are treated as Income; Commissions and other expenses are paid; Re-

serves are set up; and the remainder, if any, goes into surplus. The precedent for and the soundness of handling Initial Payment Receipts has been clearly established by more than a century of life insurance company practice.

COLLECTION REVENUE

"Collection Revenue" receives credit for the interest differential between annual and less than annual payments, and for the expense loading. The contract holder paying on a monthly basis, for example, must contribute an amount which will equalize those monthly payments with the payments made by the holders who pay annually, in advance. He must also pay an amount which will equalize the expense of handling his twelve monthly payments with the expense of handling only one annual payment. The total of these two elements makes up the Collection Revenue account.

It will be observed that in the Operating Statement we have taken 53% of this item and treated it as a *reduction* in Contract Costs. This is proper, because Gross Appropriations to Reserves were made on the basis of annual payments. Therefore, this *equalization fund*, which we have collected for this very purpose, is properly used to reduce those gross appropriations. The remaining 47% is of course used as an expense fund, and is therefore carried as an offset against operating expenses. The 53% represents the estimated average interest element and the 47% represents the expense element.

SUMMARY

In the foregoing we have shown:

- (1) The disposition of the cash received from contract holders.
- (2) The composition of the contract funds available for investment; how they are built up by investment accretions; and the build up of the reserves to a final maturity amount by the application of reserve schedules.
- (3) How these reserve schedules use a Gross Accumulation Rate, and how that Gross Rate is reduced, by known factors, to a Net Rate.
- (4) How Contract Cost, produced by that Net Rate, has been covered by Investment Income in the past.
- (5) How Contract Cost will be covered in the future.
- (6) How acquisition or procurement expense is covered, and how general operating expense is covered.

Investors Syndicate, operating statement, 1936, 1937, 1938, and first quarter of 1939

[Rearranged to illustrate the coverage of reserve requirements by investment income]

	Year 1936	Year 1937	Year 1938	First quarter 1939	Total for 3 years and 3 months
NEW BUSINESS					
INCOME					
Initial payment receipts.....	\$3,752,891.05	\$3,616,159.32	\$4,886,093.69	\$1,434,953.55	\$13,690,097.61
EXPENSE ^a					
Commissions paid.....	\$2,730,278.29	\$2,534,862.41	\$2,722,027.79	\$903,059.57	\$8,890,228.06
Advertising.....				18,192.82	18,192.82
Collection fees.....	163,886.68	189,865.34	206,528.29	92,972.53	653,252.84
Salaries.....	497,293.18	577,733.81	667,922.19	174,543.47	1,917,492.65
Rent.....	47,762.11	46,125.27	56,115.48	14,009.41	164,012.27
Collection and exchange.....	3,659.84	7,028.27	9,421.60	1,480.05	21,589.76
Insurance expense.....	17,350.06	13,604.42	9,880.00	2,110.83	42,945.31
Accounting fees.....	10,701.82	11,780.72	14,340.70	13,141.01	49,964.25
Attorney fees.....	11,198.48	20,733.92	16,105.76	4,646.38	52,684.54
Depository fees.....	14,846.09	17,247.48	20,084.68	1,671.62	53,849.87
Costs of examination.....	7,726.58	7,259.23	9,468.29	3,094.39	27,548.49
Telephone, telegraph, postage.....	49,156.10	50,571.72	54,963.71	16,848.04	171,539.57
Traveling expense.....	28,657.78	19,458.17	19,902.20	5,236.78	73,254.93
Printing and stationery.....	40,527.20	40,458.22	36,571.82	14,888.50	132,445.74
Taxes (other than income).....	29,068.02	60,383.08	67,461.39	15,338.71	172,251.20
General office expense.....	18,289.46	41,199.12	45,208.69	14,936.45	119,633.72
Convention expense.....		35,054.48			35,054.48
Miscellaneous.....	7,684.66	23,552.49	28,983.53	4,802.33	65,023.01
Depreciation—furniture and fixtures.....	15,329.31	17,279.88	19,868.37	5,029.71	57,507.27
Income taxes.....	29,722.87	16,313.16	61,652.26	16,973.51	124,661.80

Total new business expense.....	3,723,138.53	3,730,511.19	4,066,506.75	1,322,976.11	12,843,132.58
Net income from new business.....	29,752.52	114,351.87	819,586.94	111,977.44	846,965.03
INVESTMENTS AND CONTRACTS					
INVESTMENT INCOME					
<i>Credits</i>					
Interest received.....	3,319,561.91	4,400,210.55	5,243,180.43	1,421,622.48	14,384,575.37
Service fees on mortgages.....	231,934.32	243,017.83	194,601.39	56,520.82	726,074.36
Dividends on stocks.....	235,864.86	239,221.43	317,529.49	78,503.42	871,119.20
Rental income.....	740,815.60	614,896.09	734,200.39	146,815.38	2,236,727.46
Profit on bonds and securities sold.....	735,217.67	8,722.76	18,423.45	25,008.71	787,372.59
Premiums on sale of mortgages.....				44,776.66	44,776.66
Profit on real estate and mortgages.....		28,506.94			28,506.94
Total credits.....	5,263,394.36	5,534,575.60	6,507,935.15	1,773,247.47	19,079,152.58
<i>Charges</i>					
Mortgage agency expense.....	166,198.41	161,411.40	160,063.03	40,825.91	528,498.75
Real estate expense.....	597,638.54	505,898.88	533,193.72	100,361.27	1,737,092.41
Real estate depreciation.....	162,777.16	139,747.26	213,687.53	47,934.32	564,146.27
Loss on real estate and mortgages.....	109,557.72		172,638.98	24,347.25	306,543.95
Total charges.....	1,036,171.83	807,057.54	1,079,583.26	213,468.75	3,136,281.38
Net investment income.....					
See footnote at end of table.	4,227,222.53	4,727,518.06	5,428,351.89	1,559,778.72	15,942,871.20

Investors Syndicate, operating statement, 1936, 1937, 1938, and first quarter of 1939—Continued

	Year 1936	Year 1937	Year 1938	First quarter 1939	Total for 3 years and 3 months
CONTRACT COSTS					
<i>Charges</i>					
Appropriations to reserves	3,699,442.52	4,468,025.55	6,220,723.96	1,633,293.87	16,021,485.90
Interest on advance payments	369,529.68	346,944.71	352,680.43	112,819.85	1,181,974.67
Interest on interest-bearing contracts	249,629.21	286,254.80	313,072.99	83,567.86	932,524.86
Total charges	4,318,601.41	5,101,225.06	6,886,477.38	1,829,681.58	18,135,985.43
<i>Credits</i>					
53 percent of collection revenue account	542,273.38	672,128.00	740,194.93	211,149.94	2,165,746.25
Net reserves released by terminations	14,422.73	26,838.35	262,407.54	58,424.59	333,247.75
Total credits	527,850.65	698,966.35	1,002,602.47	269,574.53	2,498,994.00
Net contract cost	3,790,750.76	4,402,258.71	5,883,874.91	1,560,107.05	15,636,991.43
Net gain from investments over contract costs	436,471.77	325,259.35	b 455,523.02	328.33	305,879.77
GENERAL OPERATIONS					
<i>Credits</i>					
Expense loading (47 percent of collection revenue account)	480,883.95	596,038.04	656,399.28	187,246.18	1,920,567.45
Fees for transfers and duplicates	19,383.87	15,114.24	17,719.64	4,253.88	56,471.63
Total credits	500,267.82	611,152.28	674,118.92	191,500.06	1,977,039.08

<i>Charges</i>					
EXPENSE ^a					
Salaries.....	165,764.39	192,577.93	222,640.73	58,181.16	639,164.21
Rent.....	15,920.70	15,375.09	18,705.16	4,669.81	54,670.76
Collection and exchange.....	1,219.95	2,342.76	3,140.53	493.35	7,196.59
Insurance expense.....	5,783.36	4,534.81	3,293.33	703.61	14,315.11
Accounting fees.....	3,567.27	3,926.91	4,780.23	4,380.34	16,654.75
Attorney fees.....	3,732.83	6,911.31	5,368.59	1,548.79	17,561.52
Depository fees.....	4,948.70	5,749.16	6,694.90	557.21	17,949.97
Costs of examination.....	2,575.53	2,419.74	3,156.10	1,031.46	9,182.83
Telephone, telegraph, postage.....	16,385.37	16,857.24	18,321.24	5,616.01	57,179.86
Traveling expense.....	9,552.60	6,486.06	6,634.07	1,745.59	24,418.32
Printing and stationery.....	13,509.07	13,486.07	12,190.60	4,962.84	44,148.58
Taxes (other than income).....	9,689.34	20,127.70	22,487.13	5,112.91	57,417.08
General office expense.....	6,096.49	13,733.04	15,069.57	4,978.82	39,877.92
Miscellaneous.....	2,561.55	7,850.83	9,661.18	1,600.78	21,674.34
Depreciation — furniture and fixtures.....	5,109.77	5,759.96	6,622.79	1,676.57	19,169.09
Income taxes.....	9,907.63	5,437.72	20,551.01	5,657.83	41,554.19
Total charges.....	276,324.55	323,576.33	379,317.16	102,917.08	1,082,135.12
Net gain from general operations.....	223,943.27	287,575.95	294,801.76	88,582.98	894,903.96
MISCELLANEOUS					
Proceeds from life insurance.....			122,098.81		122,098.81
Total gain for period.....	690,167.56	498,483.43	780,964.49	200,232.09	2,169,847.57

^a Commissions, collection fees, convention expense and advertising charged 100 percent to new business. Remaining expense accounts allocated 75 percent against new business and 25 percent against general operations. This is 3-to-1 ratio as compared to customary 5-to-1 ratio used in life insurance business.

^b Excess of contract costs over investment income in 1938 due to voluntary increases in reserves over the required schedules and to voluntary prepayment of contracts prior to their maturity. These 2 items increased contract costs approximately \$573,000.

